

125 FERC ¶ 61,212
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

North American Electric Reliability Corporation

Docket Nos. RR08-4-001
RR08-4-002

ORDER ON REHEARING AND CLARIFICATION AND ACCEPTING
COMPLIANCE FILING

(Issued November 20, 2008)

1. In a June 19, 2008 order, the Commission addressed a compliance filing submitted by the North American Electric Reliability Corporation (NERC) that proposed “violation severity levels” corresponding to the requirements of mandatory Reliability Standards.¹ NERC and Edison Electric Institute (EEI) seek rehearing and clarification of the VSL Order. As discussed below, the Commission grants in part and denies in part rehearing and clarification of the VSL Order.

2. The Commission accepts NERC’s July 21, 2008 compliance filing revising certain violation severity level assignments submitted pursuant to the VSL Order. The Commission directs NERC to submit a further compliance filing that makes specific revisions discussed in section III. F below.

I. Background

3. In the June 7, 2007 Order, the Commission directed NERC to develop violation severity levels for each requirement and sub-requirement of each Reliability Standard, either through the Reliability Standards development process or through another expedited process.² NERC and the Regional Entities will use violation severity levels in

¹ *North American Electric Reliability Corp.*, 123 FERC ¶ 61,284 (2008) (VSL Order).

² *North American Electric Reliability Corp.*, 119 FERC ¶ 61,248 (June 7, 2007 Order), *order on clarification*, 120 FERC ¶ 61,239 (2007).

the determination of a penalty for an individual violation of a requirement of a Reliability Standard. NERC or the Regional Entity will establish an initial Base Penalty Amount range by finding the intersection of the applicable violation risk factor and violation severity level on the Base Penalty Amount Table in Appendix A to the NERC Sanction Guidelines. Each requirement that is assigned a violation risk factor is also assigned at least one violation severity level. The violation risk factor represents the potential reliability risk (“lower,” “medium,” or “high”) a violation of a requirement presents to the Bulk-Power System. In contrast, a violation severity level is a post-violation measurement of the degree (“lower,” “moderate,” “high,” or “severe”) to which a requirement was violated. The higher the violation risk factor and the higher the degree of the violation severity level, the higher the applicable Base Penalty Amount range for a particular violation.

4. In its compliance filing, NERC proposed violation severity levels for requirements and sub-requirements for the 83 Reliability Standards approved by the Commission in Order No. 693. In addition, NERC submitted new violation severity levels for requirements for proposed Reliability Standard NUC-001-1, Nuclear Plant Interface Coordination which, at that time, was pending before the Commission, for a total of 84 Reliability Standards filed for Commission approval. In assigning violation severity levels, NERC developed a guidance document to provide clarity and direction to the drafting teams and to ensure consistency among the standards during the assignment process.³

5. The Commission addressed NERC’s filing in the VSL Order, and articulated four guidelines for reviewing NERC’s assignment of violation severity levels:

- (1) Violation severity level assignments should not have the unintended consequence of lowering the current level of compliance;
- (2) Violation severity level assignments should ensure uniformity and consistency among all approved Reliability Standards in the determination of penalties;
- (3) Violation severity level assignments should be consistent with the corresponding requirement; and

³ NERC’s guidance document classified the requirements of Reliability Standards into seven categories, i.e., (1) procedure/program requirements, (2) implementation/execution requirements, (3) reporting requirements, (4) coordination/communication requirements, (5) numeric performance requirements (6) multi-component requirements and (7) requirements without violation risk factors assigned. With the exception of category 7, NERC defined criteria for the severity levels to be assigned to each category. *See* VSL Order, 123 FERC ¶ 61,284 at P 7.

(4) Violation severity level assignments should be based on a single violation, not on a cumulative number of violations.⁴

6. In the VSL Order, the Commission approved violation severity level assignments for the 83 Commission-approved Reliability Standards as filed but directed NERC to file, within 30 days, specific modifications to the violation severity level assignments relevant to five Reliability Standards and identified in the Appendix to the VSL Order. In addition, the Commission ordered a number of reports and further compliance filings to bring the remainder of NERC's violation severity levels into compliance with the Commission's guidelines.⁵

7. With regard to Guideline 1, the Commission noted that NERC's Compliance Enforcement Program Summary Reports from 2003 to 2006 indicate that, on average, 95 percent of applicable entities achieved 100 percent compliance with reliability standards that NERC actively monitored during that time.⁶ The Commission explained that Guideline 1 "will help to maintain at least the current level of compliance and reliability and ensure that ultimately Violation Severity Levels are not arbitrarily assigned."⁷ It added that "Guideline 1 seeks to ensure that proposed Violation Severity Level assignments will not signal to applicable entities that less compliance than that which has been historically achieved is condoned."⁸ The Commission directed NERC to file, within six months, a report on historical performance, where NERC has historical performance data, and to compare that historical compliance for individual requirements with their assigned violation severity level to insure that the violation severity level assignments do not reduce current levels of reliability (historical report).

8. In addition, the Commission stated that the violation severity level assignments could benefit from further refinement based on the Commission's four guidelines. It directed NERC to file, within six months, either justifying the inconsistency in the single violation severity level assigned to binary (pass/fail) requirements or revising those

⁴ *Id.* P 19–36.

⁵ The Commission declined to act on the violation severity levels NERC proposed for the NUC-001-1 standard. In light of the guidelines set forth in the order, the Commission directed NERC to assess these proposed violation severity levels and to resubmit them in a six-month compliance filing described in the order. *Id.* P 14, 41.

⁶ *Id.* at n.13.

⁷ *Id.* P 20.

⁸ *Id.*

assignments to reflect a consistent approach (Guideline 2a justification/revision); and to review all violation severity level assignments, except those for which the Commission directed modification, for compliance with Guidelines 2b, 3 and 4, and submit a filing, within six months, either validating or proposing revisions to those assignments (Guidelines 2b, 3, and 4 review).

9. On July 21, 2008, NERC submitted a compliance filing that revised the violation severity levels corresponding to 20 requirements relevant to five Reliability Standards, as directed by the Commission in the VSL Order.

II. Public Notice and Interventions

10. Notice of NERC's July 21, 2008 filing was published in the *Federal Register*, 73 Fed. Reg. 44,712 (2008), with comments due on or before August 20, 2008. None was filed.

III. Discussion

A. Procedural Matters

11. On July 18, 2008, The Edison Electric Institute (EEI) submitted a request for clarification. On July 21, 2008, NERC submitted a request for clarification and rehearing.

B. Use of Reliability Standards Development Procedure

12. NERC seeks clarification that it may continue to use its Reliability Standards development process identified in the NERC Reliability Standards Development Procedure for the development of violation severity levels, if that process works to produce timely results. NERC states that this clarification would be consistent with the clarification that the Commission provided with respect to the development of violation risk factors.⁹ With this clarification, NERC states that it would file to amend its Rules of Procedure to include an alternative process for developing violation severity levels if the standards process does not produce timely results. NERC adds that this approach will help ensure consistency and uniformity in the violation severity levels that apply to both the U.S. and Canadian entities.

13. The Commission grants NERC's request for clarification. The VSL Order determined that, similar to violation risk factors, violation severity levels are not part of the Reliability Standard.¹⁰ To ensure consistency with regard to the development of

⁹ *North American Electric Reliability Corp.*, 119 FERC ¶ 61,046, at P 33 (2007).

¹⁰ VSL Order, 123 FERC ¶ 61,284 at P 15.

violation risk factors, the Commission clarifies that NERC may use its Reliability Standards development process identified in the NERC Reliability Standards Development Procedure, so long as that process produces timely results to meet a Commission directive.

C. Guideline 1: Use of Historical Levels of Compliance

14. Both NERC and EEI question the use of historical compliance levels to determine the severity level of a particular violation. NERC requests that the Commission grant rehearing and revise Guideline 1 to allow NERC to gain a year of experience under the mandatory and enforceable Reliability Standards and to evaluate whether the desired level of compliance is being achieved.

15. NERC states that it agrees that the violation severity levels should not provide perverse signals to industry participants that it will be acceptable to reduce performance. However, it believes that the historical levels of non-compliance are inadequate for use in a mandatory environment. NERC states that the use of historical data accumulated for requirements in a voluntary environment is an inappropriate indicator of expected performance in a mandatory environment. NERC argues that actual performance is a superior alternative to historical data that may have little relevance given the significant changes that have resulted in the nature and scope of Reliability Standards, the nature and number of entities rising from 200 to 1,800 registered entities, and the increased number of functional entity categories. NERC adds that, under the voluntary environment, only 200 functional entity designations were registered in the compliance enforcement program and performance pertained primarily to implementing operational policies or transmission planning.

16. In addition, according to NERC, under the voluntary regime, levels of non-compliance were not developed consistently over the course of their history.¹¹ Some were developed in the context of projects affecting all of NERC's Reliability Standards, such as the effort to add measures of non-compliance to most of the Version 0 standards that were initially approved without these elements. Levels of non-compliance that assessed the risk to the Bulk-Power System ultimately became violation risk factors; others assessed the degree of non-compliance and reflect the violation severity levels that are the subject of the VSL Order. NERC contends that it would be a huge undertaking to

¹¹ "Levels of Non-Compliance" are established criteria for determining the severity of non-compliance with a Reliability Standard. The Levels of Non-Compliance range from Level 1 to Level 4, with Level 4 being the most severe. *See Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242, at P 238, n.119, *order on reh'g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

evaluate the overall quality of the historical compliance data because a comprehensive review of the information would need to be performed.

17. Further, NERC questions whether the historical data is truly reflective of the compliance performance of the associated entities. According to NERC, this assumption is inconsistent with its experience immediately prior to the mandatory standards becoming effective in the United States, when a number of entities, faced with potential sanctions, self-reported that they were in violation of NERC's Reliability Standards.

18. Finally, NERC argues that the VSL Order fails to specify how a set of violation severity levels might result in lowering the current level of compliance. NERC states that it has safeguards in place in its compliance enforcement program to prevent an entity from choosing not to comply based on an economic decision, and accordingly, NERC does not believe that the associated set of violation severity levels proposed will lead to the unintended consequence of lowering the intended level of compliance. As noted above, NERC asserts that the superior approach is to collect the data for 2008 and to evaluate actual performance.

19. Accordingly, NERC asks that the Commission allow NERC to collect and analyze data for one full year (i.e., 2008) under the mandatory scheme as the basis for the historical report. Because of the reasons explained above, NERC also requests that the Commission eliminate its directive with regard to the use of historical data gathered under the voluntary regime.

20. Like NERC, EEI argues that the guidance document NERC uses in setting violation severity levels ensures that these levels are not arbitrarily assigned and questions how reference to historical compliance data will ensure that the goal of Guideline 1 is achieved. EEI requests that the Commission clarify its intent and purpose in requiring this analysis, the reason for the link between historical compliance and establishing violation severity levels, and how the use of historical data relates to the requirement in section 215(c) of the Federal Power Act (FPA) that the Electric Reliability Organization develop Reliability Standards that provide for an "adequate level of reliability." EEI states that the purpose of the violation severity levels is to define the degree to which compliance with a Reliability Standard was not achieved, and in conjunction with the violation risk factor, it is considered in the determination of a base financial penalty amount for violation of a particular Reliability Standard. EEI argues that Order No. 672 and Order No. 693 do not establish a link between setting a violation severity level and historical compliance.

21. EEI also requests clarification of the Commission's reference to both historical "compliance" and "performance." EEI states that it is uncertain whether the Commission is looking at compliance versus non-compliance or overall performance.

Commission Determination

22. The Commission denies NERC's request to use *only* 2008 data for the evaluation of violation severity level assignments. The Commission grants NERC's request to collect the additional 2008 compliance data it requests and directs NERC to use both historical data as the Commission intended in the VSL Order and 2008 compliance data in its evaluation of assigned violation severity levels applying Guideline 1.

23. The Commission believes that historical data provides a reasonable baseline to assess whether assigned violation severity levels may encourage reduced levels of compliance performance. If assigned violation severity levels are not measured against some performance baseline, the assigned violation severity level is (1) ultimately arbitrary and (2) could encourage less rigorous compliance. As the Commission stated in the VSL Order, “[t]he Commission believes the application of Guideline 1 will help to maintain at least the current level of compliance and reliability and ensure that ultimately Violation Severity Level assignments will not signal to applicable entities that less compliance than that which has been historically achieved is condoned.”¹²

24. Guideline 1 is also consistent with the Commission's determination in Order No. 672 that the ERO's Rules should be developed to further the ERO's and Regional Entities' purpose – which is to support and improve Bulk-Power System reliability.¹³ Violation severity levels likewise should be formulated to improve Bulk-Power System reliability because the Commission has determined that they appropriately are treated as an appendix to NERC's Rules of Procedure.¹⁴ More broadly, the Commission has stated that “the fundamental goal of mandatory, enforceable Reliability Standards and related enforcement programs is to promote behavior that supports and improves Bulk-Power system reliability.”¹⁵ The ERO develops mandatory Reliability Standards that provide for an adequate level of reliability, consistent with section 215 of the FPA, and assigns violation severity levels, that, as an appendix to the ERO's Rules, should further the

¹² *Id.* P 20.

¹³ *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 113, *order on reh'g*, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006) (“the Rules of the ERO and Regional Entities. . . should be developed to further the ERO's and Regional Entities purpose – which is to improve Bulk-Power System reliability”).

¹⁴ VSL Order, 123 FERC ¶ 61,284 at P 17.

¹⁵ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 455 (emphasis added).

purpose of improving Bulk-Power System reliability. The Commission believes, consistent with Order No. 672, the advent of mandatory compliance with Reliability Standards should compel a level of compliance representing improved reliability over the level of reliability that was achieved under voluntary compliance. In order not to inadvertently assign violation severity levels that lower the level of compliance established under the voluntary regime, historical compliance data from the voluntary regime must be used, where applicable. For example, if historical performance data for a requirement indicates that the majority of entities were no more than five percent non-compliant with that requirement, NERC should consider that historical data as the baseline when it applies Guideline 1 to assess whether the assigned violation severity levels have the potential to lower the current level of compliance.

25. As the Commission stated in the VSL Order, NERC's approach to developing requirement-specific violation severity levels is generally appropriate and provides a systematic method to ensure that requirements of the same category are assigned similar, but requirement-specific, violation severity levels.¹⁶ However, NERC's process does not specifically consider the "unintended consequence of lowering the current level of compliance" (Guideline 1). Thus, the Commission is concerned that, in some instances, the process NERC applied, although consistent with its guidelines, could result in the arbitrary assignment of violation severity levels and a reduction of the current levels of compliance which Guideline 1 was developed to prevent. For example, NERC assigned a "lower" violation severity level for an entity found non-compliant with up to 25 percent of its maintenance and testing, i.e., an entity found to have not maintained and tested up to 25 percent of its protection systems.¹⁷ The Commission is concerned that if historical data indicates the severest degree to which the majority of entities have been found to have violated the requirements is far lower than the 25 percent NERC assigned at the lowest violation severity level, the assigned violation severity level provides a "perverse incentive"¹⁸ for industry participants to reduce their current level of compliance and consequently, the resultant level of reliability. As stated above, consistent with Order No. 672, violation severity levels should be developed to further the ERO's and Regional Entities' purpose: to improve Bulk-Power System reliability.

26. The Commission understands that the number of entities upon which the historical baseline will be developed is much smaller than the number of entities to which the baseline will be applied. The approximately 200 entities whose voluntary compliance

¹⁶ VSL Order, 123 FERC ¶ 61,284 at P 16.

¹⁷ Reliability Standard PRC-005-1, Transmission and Generation Protection System Maintenance and Testing, Requirements R1.1 and R1.2.

¹⁸ See NERC July 21, 2008 Request for Rehearing at 10.

data would establish the baseline were the larger entities of the Bulk-Power System during the voluntary regime in terms of Bulk-Power System facilities or load and are most likely still the entities under the mandatory regime that are subject to the largest number of mandatory Reliability Standards. Thus, the Commission believes those 200 entities would be considered a representative sample of the Bulk-Power System and the historical compliance data of those entities would be a reasonable baseline from which to assess whether assigned violation severity levels would establish lower levels of compliance than historically achieved. The Commission would not expect that levels of compliance would necessarily differ as between these entities and entities that NERC placed on its registry later or that use, own, or operate fewer Bulk-Power System facilities, in view of the lead time the latter entities had to prepare for compliance with mandatory standards that NERC approved and the Commission's expectation that compliance should be the norm for all registered entities.

27. The Commission also understands that the mandatory regime introduced new functional entities and that for those new functions, there is no historical data to use as a baseline. As such, the Commission reiterates that the VSL Order provided NERC the discretion to determine the appropriate data to be used to make its assessment when it applies Guideline 1.¹⁹

28. NERC also argues that the high number of self-reported violations of Reliability Standards immediately prior to the effective date of the mandatory and enforceable Reliability Standards is sufficient cause to discount the validity of the historical data. The Commission is not persuaded by this argument. NERC has publicly explained that the high number of pre-June 18, 2007 self-reported violations is due primarily to (1) a large number of documentation-related violations and (2) registered entities new to the mandatory program.²⁰ Because of this explanation, the Commission believes that the high number of self-reports is more indicative of a preemptive attempt by entities to identify

¹⁹ VSL Order, 123 FERC ¶ 61,284 at P 21.

²⁰ NERC News, August 2007 located at: <https://www.nerc.com/fileUploads%5CFile%5Cnewsletters/NERCNews-2007-08.pdf>. NERC further explained that of the nearly 4,100 reports of violations, over 2,200 (the most common type of alleged violation) are administrative in nature where the entity is performing the necessary tasks to preserve reliability, but its documentation may not be sufficient to demonstrate compliance during a compliance audit. NERC identified the second largest type of alleged violation as committed by new players with new requirements coming into compliance for the first time; the third largest type as entities that self-reported, but have been found to be in compliance by a Regional Entity and a final type that NERC describes as small, but includes some alleged violations that are serious.

any and all potential violations prior to the implementation of penalties rather than an indication that compliance records under the voluntary regime are inaccurate.

29. NERC also argues that it has safeguards in place in its compliance enforcement program to prevent an entity from choosing not to comply based on an economic decision. However, the effectiveness of NERC's safeguards is not at issue here. This proceeding pertains to the assignment of violation severity levels. Violation severity levels and NERC's safeguards should be complementary and not contradictory in furthering this purpose. Violation severity levels that encourage lower compliance levels contradict the safeguards NERC has in place. Further, no safeguards can prevent entities from making rational economic choices to violate if the violation severity levels are assigned in such a way that the cost of violation is less than the cost of compliance.

30. In summary, the Commission denies NERC's request to revise its directive with respect to Guideline 1 to eliminate reference to historical data. However, the Commission grants NERC's request to review 2008 compliance data and directs NERC to use both pre-2008 historical data, as appropriate, and 2008 compliance data in its evaluation of assigned violation severity levels applying Guideline 1. NERC must identify and compare (i) each requirement and its current violation severity level assignment, (ii) the requirement's pre-2008 historical data, and (iii) the requirement's 2008 compliance data. Where NERC determines that a requirement's violation severity level assignments are not consistent with either the requirement's pre-2008 historical compliance data or its 2008 compliance data, NERC should submit either (i) revised assignments or (ii) a justification of the current violation severity levels assignments. If revised assignments are submitted, NERC should discuss which data it used to revise the assignments.

31. With regard to EEI's filing, the Commission grants EEI's request for clarification regarding its use of the terms "compliance" and "performance." The Commission clarifies that, in the VSL Order, it meant the use of historical compliance data, and did not intend a separate analysis of historical performance apart from compliance.

32. The Commission agrees with EEI that the purpose of the violation severity levels is to define the degree of non-compliance. The reference to historical data does not change the purpose of the violation severity level assignment; nor is it inconsistent with Order No. 672 or Order No. 693. Rather, as explained in detail above, the Commission believes that historical data provide a reasonable baseline upon which violation severity levels could be assigned and assessed.

D. Timeline for Compliance Filings

33. NERC argues that the Commission's directives to perform and submit reports and compliance filings within six months "lacks a sound rationale" given that, in the VSL Order, the Commission (1) approved violation severity levels that will be in place in the

summer of 2008; (2) reviewed and directed changes to certain specific violation severity level assignments; (3) previously directed a general review of a significant number of Reliability Standards and the associated violation risk factors and violation severity levels as part of NERC's three-year Reliability Standard development process work plan; and (4) did not identify specific concerns with respect to the factors considered by NERC or the totality of NERC's proposed violation severity levels. NERC asserts that the subject reports and compliance filings would require significant and seemingly unnecessary diversion of resources devoted to other pressing initiatives already underway and will likely produce suboptimal results, if any.

34. NERC seeks an extension of time for the three compliance filings that the Commission directed NERC to file within six months of the issuance of the VSL order. With regard to the historical report, as discussed above, NERC asks that the Commission allow NERC to collect and analyze data for one full year (i.e., 2008) under the mandatory regime as the basis for a compliance filing, without reference to earlier historical data. With regard to the remaining two filings, the Guideline 2a justification/revision concerning binary requirements where a single violation severity level was not assigned to the requirement, and the review of all violation severity level assignments, except those for which the Commission directed modification, for compliance with Guidelines 2b, 3, and 4,²¹ NERC believes that, in all events, changes to violation severity levels should be made on a prospective basis. NERC contends that a better approach is to permit NERC to include the required reviews of violation severity levels as part of NERC's three-year work plan to review and reevaluate Reliability Standards, as well as the associated violation severity levels. NERC adds that this effort is already underway.

Commission Determination

35. The Commission denies NERC's request for rehearing on the timeline for the Guideline 2a justification/revision compliance filing. However, to provide NERC additional time to adequately address the Commission's directives and collect the additional data NERC requests, the Commission grants NERC a nine-month extension to submit the historical report and the Guideline 2b, 3, and 4 review compliance filing. Thus, NERC is directed to make this compliance filing on or before September 18, 2009.

²¹ Guideline 2b refers to violation severity level assignments that contain ambiguous language; Guideline 3 calls for consistency between the violation severity level and the corresponding requirement so that the violation severity level does not redefine or undermine the requirement; and Guideline 4 states that a violation severity level assignment should be based on a single violation, not on a cumulative number of violations.

36. The VSL Order directed NERC to submit a compliance filing within six months that either justified or revised inconsistencies in the single violation severity level assigned to binary requirements (Guideline 2a justification/revision). As currently approved, inconsistent violation severity levels assigned to binary requirements do not ensure uniformity and consistency in the determination of monetary penalties. The Commission believes that the directive to justify the inconsistencies or modify the single violation severity level criteria by consistently applying the same severity level should not require an extensive review or possible revision of the current text of approved violation severity levels. Rather, the Commission believes it should be a largely administrative effort, not a huge technical undertaking, to justify the inconsistency or move the single violation severity level criterion for each binary requirement to the one level that NERC determines is appropriate for binary requirements. Accordingly, the Commission denies the request for an extension of time with regard to the Guideline 2a justification/revision compliance filing.

37. With regard to NERC's claim that the Commission did not identify specific concerns with the factors considered by NERC in its process to assign violation severity levels, the Commission stated in the VSL Order that NERC's approach to developing requirement-specific violation severity levels is generally appropriate and provides a systematic method to ensure that requirements of the same category are assigned similar, but requirement-specific, violation severity levels.²² However, instead of identifying specific concerns with each requirement and its assigned violation severity levels, the Commission developed guidelines to address, in general, the Commission's concerns with validating a requirement's violation severity level assignments.

38. The Commission is not persuaded by NERC's argument that additional time is warranted based on the fact that the Commission already approved the violation severity levels. The Commission agrees that, with the exception of a few targeted revisions, the VSL Order approved violation severity levels as filed to ensure that the complete penalty setting mechanism would be in place for the summer of 2008. However, the Commission stated in the VSL Order that some approved violation severity levels raise concern and could benefit from further refinement based on the guidelines set forth in the order.²³ Thus, the Commission developed the subject directives to ensure that, like the immediate revisions the Commission directed in the order, the remaining approved violation severity levels would, in a timely manner, conform to Commission guidelines.

39. For this reason, NERC's request to include the directed Commission reviews of approved violation severity levels as part of its three-year work plan is denied. NERC's

²² *Id.* P 16.

²³ *Id.* P 41.

three-year work plan does not include every Reliability Standard requirement approved in Order No. 693 and its associated violation severity levels. As such, NERC's review would not include some Reliability Standards approved in Order No. 693, contrary to the Commission's directive. The Commission determined in the June 7, 2007 Order that the development of violation severity levels over the course of three years is not acceptable.²⁴ Similarly, the review of violation severity levels to conform to Commission guidelines over the course of three or more years is also not acceptable.

40. For the reasons discussed above, the Commission denies NERC's request for rehearing on the timeline for the Guideline 2a justification/revision compliance filing. However, to provide NERC additional time to adequately address the Commission's directives and collect the additional data NERC requests, the Commission grants NERC a nine-month extension to submit the historical report and the Guideline 2b, 3, and 4 review compliance filing.

E. Guideline 4: Violation Severity Levels Should Be Based on a Single Violation, Not on a Cumulative Number of Violations

41. The Commission developed Guideline 4 to ensure that violation severity level assignments are based on a single violation of a Reliability Standard and not based on a cumulative number of violations of the same requirement over a period of time. The Commission stated that the application of Guideline 4 is appropriate because, unless otherwise stated in the requirement, each instance of non-compliance with a requirement is a separate violation. Section 4 of the Sanction Guidelines states that assessing penalties on a per violation, per day basis is the "default" for penalty calculations.²⁵ The Commission further stated that Guideline 4 is consistent with section 316A of the Federal Power Act (FPA), which establishes the statutory maximum penalty amount of \$1 million per day, per violation.²⁶

²⁴ June 7, 2007 Order, 119 FERC ¶ 61,248 at P 80.

²⁵ See VSL Order, 123 FERC ¶ 61,284 at P 35 & n.20 (quoting Section 4.0 of the NERC Sanction Guidelines that, "[u]nless NERC or the regional entity deems alternative frequency or duration is warranted, penalties shall be assessed on a per violation per day basis.")

²⁶ 16 U.S.C. § 825o-1(b) (Supp. V 2005). The Commission found that FPA section 316A sets an upper limit on the penalties that the Commission, NERC, and Regional Entities may impose pursuant to FPA section 215(e). Order No. 672 at P 575.

Request for Rehearing

42. NERC seeks rehearing with respect to three issues related to Guideline 4 and states that changes to Guideline 4 and the Commission's implementing paragraphs are required to ensure clarity in the assignment of violation severity levels. NERC asserts that the Commission's proposed approach could potentially result in significant financial penalties without a corresponding benefit to improving reliability.

43. First, NERC objects to the Commission's statement that "unless otherwise stated in the requirement, each instance of non-compliance with a requirement is a separate violation." NERC states that assessing a penalty for some violations on a "per violation, per day basis," may result in a penalty that may not be reasonably related to the seriousness of the violation. According to NERC, the use of the term "requirement" is inappropriate because other provisions in a given Reliability Standard, such as the "Additional Compliance" section, may address the issue. NERC adds that its Reliability Standards Development Procedure provides that "the time period in which performance or outcomes is measured, evaluated, and then reset" is part of the compliance elements of a standard, not in the requirement itself.²⁷ Therefore, NERC asserts that the implementing provisions should make clear that the language in the Reliability Standard in total governs and not simply the requirements contained in the Reliability Standard.

44. Second, NERC argues that the Commission should make clear that violation severity level assignments may be based on a larger sample size, as appropriate, to ensure that the resultant penalty bears a reasonable relation to the violation itself. NERC comments that it is not appropriate to require the "compliance enforcement authority" to look at just one limited, discrete sample in analyzing the data. NERC states that this is particularly true where a more accurate picture of compliance activities would be developed by looking at a larger sample size, such as over the entire day.

45. Third, NERC seeks rehearing and claims that the Commission should revise Guideline 4 to make clear that the Commission defers to NERC to determine the method for assigning violation severity levels in accordance with the provisions of a given Reliability Standard.

Commission Determination

46. The Commission denies NERC's request for rehearing with respect to this issue. With regard to the implementing paragraphs related to Guideline 4 which states that, "unless otherwise stated in the requirement, each instance of non-compliance with a

²⁷ NERC Rules of Procedure, Appendix 3A, Reliability Standards Development Procedure, Version 6.1, at 9.

requirement is a separate violation,” the Commission believes that the use of the term “requirement” is appropriate. The phrase, “unless otherwise stated in the requirement” is consistent with the applicable provisions of NERC’s Sanction Guidelines. Under the subject heading of “Cumulative Over Time,” section 3.21 of the Sanction Guidelines states, “[c]ertain requirements of the Reliability Standards are measured not on the basis of discrete acts, but of cumulative acts over time.” Under the subject heading of “Periodically Monitored Discrete Violation,” section 3.21 further provides: “Some Reliability Standards may involve discrete events which are only monitored periodically or which are reported by exception. If a requirement of such a standard states that a discrete event constitutes a violation, then (i) a violation arises when that event occurs and (ii) the violation continues until remedied; furthermore, (iii) the violation is deemed to have occurred at the point that the entity entered into noncompliance with the standard regardless of the monitoring period for the activity or its date of discovery or reporting.” NERC’s rehearing request is inconsistent with its Sanction Guidelines to the extent that NERC now attempts to insert a consideration of monitoring or reporting provisions of standards into determinations about whether violations occur or whether to assess penalties for them on a basis other than “per violation, per day.”

47. Neither is NERC’s criticism of the VSL Order’s analysis of this point correct. The example the Commission used in the VSL Order on this point, Reliability Standard IRO-004-1, Requirement R6, states that if a reliability coordinator’s system studies indicate potential violations of system operating limits or Interconnection Reliability Operating Limits, the reliability coordinator shall direct its transmission operators, balancing authorities and transmission service providers to take any action the reliability coordinator deems appropriate. NERC argues that part 1.1 of the “Compliance Monitoring Responsibility” provision of the Reliability Standard requires a reliability coordinator to prepare a monthly exception report to its Regional Entity on the dates during that month for which it failed to prepare studies required by IRO-004-1. However, part 1.1 requires exception reporting in instances in which reliability coordinators do not prepare system studies, as required by Requirement R1 of the Reliability Standard, rather than Requirement R6, the example the Commission used, which presupposes that the reliability coordinator conducted the studies. Moreover, as discussed above, NERC’s Sanction Guidelines state that the duration of reporting or monitoring periods set forth in standards do not affect the occurrence of a violation that results from a discrete act, or a failure to perform a discrete act, that is described in a requirement.²⁸ Nor has NERC explained why the period of time covered by an exception

²⁸ See NERC Sanction Guidelines at section 3.21 (“For example, if a task required by a Reliability Standard requirement has not been done by the required date, it is irrelevant that monitoring for compliance with this requirement occurs only on a yearly or other periodic basis; NERC or the regional entity will deem a violation to have occurred on the first day of noncompliance and each day thereafter until compliance is

(continued...)

report should be relevant to the assessment of a violation severity level for a single violation that occurred during the reporting period.

48. The Commission also disagrees that it should make clear that violation severity level assignments may be based on a larger sample size, as appropriate, to ensure that the resultant penalty bears a reasonable relation to the violation itself. Section 4.1.2 of NERC's Sanction Guidelines states that "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." This language focuses assessment of a violation severity level on the specific violation of the requirement that occurred, not on a group of compliance data that includes that violation.

49. While NERC points out that certain requirements warrant assessing penalties on a "per event" basis, section 3.21, Frequency and Duration of Violations, Cumulative Over Time, of the Sanction Guidelines already addresses NERC's concerns by recognizing that penalties for some violations of some requirements should not be assessed on discrete acts. It would be appropriate to set violation severity levels for these requirements on the basis of cumulative quantities over time. Further, while NERC states that other violations of other requirements potentially could occur as often as once every three seconds, the Commission addressed that potential by approving language in section 3.21 of the Sanction Guidelines concerning multiple instances of violation on one day.²⁹

50. The Commission also disagrees that the text of Guideline 4 should be revised to make clear that the Commission defers to NERC to determine the method for assigning violation severity levels, in accordance with the provisions of a given Reliability Standard. As discussed previously, Guideline 4 is consistent with the NERC Sanction Guidelines. The Commission recognized, however, that compliance with some requirements is not measured on discrete acts when it approved the NERC Sanction Guidelines and allowed NERC or the Regional Entity discretion as to the frequency or

effectuated. Similarly, if a discrete event occurs and is not remedied on the date of occurrence, then NERC or the regional entity will deem a violation to have occurred on the day of the first instance of the noncompliance and each day, or portion thereof thereafter until compliance is effectuated.")

²⁹ *North American Electric Reliability Corp.*, 121 FERC ¶ 61,033 at P 12, 14 (2007).

duration of violation when assessing monetary penalties for those types of requirements.³⁰

51. For the reasons discussed above, the Commission denies rehearing on the revision of Guideline 4 and its implementing paragraphs. Guideline 4 is consistent with the statute and NERC's Sanction Guidelines.

F. Commission-Directed Changes to Violation Severity Levels

52. NERC states that the Commission directed certain revisions to violation severity levels that are inconsistent with the Commission's guidelines articulated in the VSL Order as discussed below.

1. EOP-003-1, Requirement R3

53. Reliability Standard EOP-003-1, Requirement R3 requires each transmission operator and balancing authority to coordinate load shedding plans among other interconnected transmission operators and balancing authorities. In the VSL Order, the Commission, applying Guideline 2b, which addresses ambiguous language, directed NERC to revise the violation severity level assignments for this requirement by replacing ambiguous language such as "missing minor details" with specific percentage figures.³¹

54. NERC argues that the Commission erred in revising the violation severity levels associated with Reliability Standard EOP-003-1, Requirement R3. Specifically, NERC objects to the directive to replace subjective terms such as "minor exception" with specific percentages in Requirement R3. NERC states that it agrees with the Commission's effort to remove ambiguity in the violation severity levels, but it is concerned that the use of simple percentages with respect to the number of affected entities will result in inconsistent determinations of penalties across the United States. For example, according to NERC, using the Commission's criteria, an entity that has ties with up to six other entities would be assigned a severe violation severity level for failure to coordinate with one entity and would never be assigned any level other than severe, while an entity with ties to 15 entities that fails to coordinate with one entity would receive a violation severity level assignment of moderate.

³⁰ As previously noted, section 3.21 of the NERC Sanction Guidelines discusses requirements that are not measured on the basis of discrete acts, but measured based on cumulative acts over time.

³¹ See VSL Order, 123 FERC ¶ 61,284, Appendix at 1-2.

55. NERC states that a more appropriate approach would be to identify the number of entities with ties to the applicable entity and determine a number of entities with whom they did not coordinate for each category of violation severity level. NERC proposes the following violation severity level assignments:

Lower: For Transmission Operators or Balancing Authorities required to coordinate with:

- Between four and nineteen entities, inclusive, coordinated with all but one of the required entities.
- More than 20 entities, coordinated with 95 percent or more but less than 100 percent of all required entities.

Moderate: For Transmission Operators or Balancing Authorities required to coordinate with:

- Between four and nineteen entities, inclusive, coordinated with all but two of the required entities.
- More than 20 entities, coordinated with 90 percent or more but less than 95 percent of all required entities.

High: For Transmission Operators or Balancing Authorities required to coordinate with:

- Four or less entities, coordinated with all but one of the required entities.
- Between four and nineteen entities, inclusive, coordinated with all but three of the required entities.
- More than 20 entities, coordinated with 85 percent or more but less than 90 percent of all required entities.

Severe: For Transmission Operators or Balancing Authorities required to coordinate with:

- Four or less entities, coordinated with all but two or more of the required entities.
- Between four and nineteen entities, inclusive, coordinated with all but four or more of the required entities.
- More than 20 entities, coordinated with 0 percent or more but less than 85 percent of all required entities.

56. The Commission denies NERC's request for rehearing on this issue. The Commission directed revision of the violation severity levels NERC filed for the subject requirement because they contained arbitrary language, inconsistent with Guideline 2b, and would result in the inconsistent determination of monetary penalties. NERC's proposed alternative language introduces seemingly arbitrary cut-offs relative to the number of ties among applicable entities for each violation severity level, which would

be inconsistent with Guideline 1. The Commission believes that the use of a percentage of ties rather than a fixed number of ties in determining violation severity levels for this requirement is more appropriate because the use of percentages, as it relates to this requirement, more closely reflects the *severity* of the violation. The Commission agrees that the violation severity levels could be refined to allow for broader violation severity level ranges (by increasing the percentages) to better account for the varied number of ties among applicable entities. However, revising violation severity levels prior to the review of historical data would be premature. If NERC's analysis of historical data supports further revision of this violation severity level assignment, NERC can submit, and the Commission will consider such revision when it receives the future filing on Guideline 1. Accordingly, NERC's request is denied.

2. EOP-003-1, Requirement R4

57. Reliability Standard EOP-003-1, Requirement R4 requires a transmission operator or balancing authority to consider one or more of a specific list of five elements (frequency, rate of frequency decay, voltage level, rate of voltage decay, or power flow levels) in designing an automatic load shedding scheme. In the VSL Order, the Commission revised the violation severity level assignments for this requirement by deleting ambiguous language such as "missing minor details or minor program/procedural elements" and revising the assignments to reflect a binary (pass/fail) approach under which, if the entity failed to consider one of the five required elements, it received a "severe" violation severity level.³²

58. NERC disagrees with the Commission's direction that NERC modify Reliability Standard EOP-003-1, Requirement R4 as a "binary" (pass/fail) requirement that defaults to a "severe" violation severity level when an entity does not consider one of the five required elements. Stating that this directive could be interpreted as requiring that all five elements must be considered, NERC urges the Commission to adopt the following language:

Severe: The Transmission Operator or Balancing Authority did not consider at least one of the five elements (frequency, rate of frequency decay, voltage level, rate of voltage decay, or power flow levels) listed in the requirement.

59. The Commission's revision did not intend that all five elements must be considered by the applicable entity. As such, the Commission grants NERC's request for rehearing on this issue and accepts NERC's proposed alternative language.

³² *Id.*, Appendix at 2.

3. EOP-003-1, Requirement R7

60. Reliability Standard EOP-003-1, Requirement R7 specifies that a transmission operator or balancing authority must coordinate its automatic load shedding with other automatic actions that are expected to occur under abnormal frequency, voltage, or power flow conditions. The Commission directed that this requirement's violation severity levels be revised such that they utilize a percentage of automatic actions with which the entity did not coordinate to determine the appropriate violation severity level.³³

61. NERC asserts that the change introduces further ambiguity. NERC questions whether the violation severity levels apply to an entire group of "automatic actions" or to individual "automatic actions." NERC also questions whether generator underfrequency relaying coordination with all generators is considered one automatic action or whether coordination with each individual generator is considered an individual automatic action. NERC adds that, if coordination of generator underfrequency relaying with all generators is considered one automatic action, NERC is concerned that the assigned five percent increments are overly restrictive. NERC proposes the addition of the following statement to the violation severity levels: "Coordination with individual generating units is considered as one automatic action for purposes of determining Violation Severity Levels."

62. The Commission revision is based on the understanding that coordination with individual generating units is considered as one automatic action. As such, the Commission grants NERC's request for rehearing on this issue and accepts NERC's proposed additional statement for clarification.

4. FAC-003-1, Requirement R1.1

63. Reliability Standard FAC-003-1, Requirement R1.1 requires that a transmission owner develop a "transmission vegetation management plan" (Vegetation Plan) and that the Vegetation Plan contain the schedules and type of inspections that are performed with regard to right-of-way vegetation. NERC's filed violation severity levels for this requirement appeared not to consider whether the type of right-of-way inspection was specified in the Vegetation Plan. To be consistent with the requirement, the Commission directed the revision of the violation severity levels to consider the specification of the type of inspection.³⁴

³³ *Id.*, Appendix at 3.

³⁴ *Id.*, Appendix at 5.

64. NERC seeks rehearing of this directed revision. NERC is concerned that the approach the Commission directed with respect to the high violation severity level redefines the requirement, and therefore, violates Guideline 3. According to NERC, the language of Requirement R1.1 states that the Vegetation Plan should have a schedule *and* type of inspection specified. NERC believes that these two concepts should be viewed concurrently because the success of the overall Vegetation Plan is conditioned on both aspects with respect to action on specific facilities. NERC contends that this requirement is appropriately treated as a binary requirement.

65. The Commission denies NERC's request for rehearing on this issue. The Commission agrees that the fulfillment of the objective of any requirement is conditioned on compliance with all components of the requirement. As the Commission acknowledged in the VSL Order, a binary approach in the assignment of violation severity levels is appropriate for certain requirements but, as a general rule, graduated violation severity levels, wherever possible would be preferable because the application of any penalty for a violation could be more consistently and fairly applied commensurate with the degree of the violation.³⁵ Because of this consideration, the Commission's revisions are not inconsistent with Guideline 3. FAC-003-1, Requirement R1.1, establishes that a Vegetation Plan shall define a schedule that is: (1) flexible and (2) anticipates growth and any other operational factors. The subject requirement also establishes that the Vegetation Plan defines the type of right-of-way inspection. If the Vegetation Plan does not define a schedule that contains the two necessary elements or the type of right-of-way inspection, the Commission directed that the ERO assign a "high" violation severity level. NERC's filed violation severity levels appeared not to consider whether Vegetation Plan specified the type of right-of-way inspection. The Commission-directed revisions are based on the elements necessary for the schedule, as directed by the requirement, and the specification of the type of right-of-way inspection.

5. FAC-003-1, Requirement R2

66. FAC-003-1, Requirement R2 specifies that a transmission owner must create and implement an annual plan for vegetation management. The transmission owner must include the methods used, document adjustments to the plan, and have systems and procedures for documenting and tracking work performed under the plan. The Commission directed revisions to the violation severity levels to utilize the number of required elements as one way to determine lower, moderate, and high violation severity level assignments, and treat absence of the plan or lack of implementation of it as a "severe" violation severity level.³⁶

³⁵ *Id.* P 27.

³⁶ *Id.*, Appendix at 6–8.

67. NERC is concerned that the Commission's revisions do not fully eliminate the ambiguity and proposes the following language:

Lower: The Transmission Owner did not meet one of the three required elements (including in the annual plan a description of methods used for vegetation management, maintaining documentation of adjustments to the annual plan, or having systems and procedures for tracking work performed as part of the annual plan) specified in the requirement.

Moderate: The Transmission Owner did not meet two of the three required elements (including in the annual plan a description of methods used for vegetation management, maintaining documentation of adjustments to the annual plan, or having systems and procedures for tracking work performed as part of the annual plan) specified in the requirement.

High: The Transmission Owner did not meet the three required elements (including in the annual plan a description of methods used for vegetation management, maintaining documentation of adjustments to the annual plan, or having systems and procedures for tracking work performed as part of the annual plan) specified in the requirement.

Severe: The Transmission Owner does not have an annual plan for vegetation management, or the Transmission Owner has not implemented the annual plan for vegetation management.

68. The Commission agrees that NERC's alternative proposal provides further clarity for the description of the severity levels associated with FAC-003-1, Requirement R2. Accordingly, the Commission grants NERC's request for rehearing on this issue and accepts NERC's proposed alternative language.

6. VAR-001-1, Requirement R1

69. VAR-001-1, Requirement R1 states that transmission operators shall develop formal policies and procedures for monitoring and controlling voltage and MVAR flows. The Commission directed NERC to incorporate specific language using the percentage of individual and neighboring areas' voltage levels and MVAR flows affected by the violation of this requirement to determine the violation severity levels for it.³⁷

³⁷ *Id.*, Appendix at 11–12.

70. NERC states that the Commission-directed violation severity levels are ambiguous in that it would be difficult to determine how voltage levels and MVAR flows are “affected” by a violation as the Commission language specifies. NERC proposes instead that these violation severity levels be based on the existence of the policies and procedures, whether they are current, if they have been implemented, and the number of neighbors with which they have been coordinated. NERC proposes the following alternative language:

Lower: N/A

Moderate: The Transmission Operator has formal policies and procedures for monitoring and controlling voltage and MVAR flows, but they are not current.

High: The Transmission Operator has formal policies and procedures for monitoring and controlling voltage and MVAR flows that are current, but they have not been coordinated with one or more neighboring Transmission Operators.

Severe: The Transmission Operator has formal policies and procedures for monitoring and controlling voltage and MVAR flows, but has not implemented them; or, the Transmission Operator does not have formal policies and procedures for monitoring and controlling voltage and MVAR flows.

71. The Commission grants NERC’s request for rehearing on this issue. The Commission believes NERC’s proposed alternative language addresses the Commission’s concern with regard to quantifying non-compliance with the monitoring and control of voltage and MVAR flows. As such, the Commission accepts NERC’s proposed alternative language.

7. **VAR-001-1, Requirement R8**

72. VAR-001-1, Requirement R8 states that the transmission operator shall operate or direct the operation of capacitive and inductive reactive resources within its area to maintain system and Interconnection voltages within established limits. In the VSL Order, the Commission directed that, to determine the violation severity levels for this requirement, NERC use a percentage based on the number of load shedding resources operated or directed to operate..³⁸

³⁸ *Id.*, Appendix at 15–16.

73. NERC seeks rehearing and explains that the original violation severity levels were based on the duration when the transmission operator was able to meet the requirement. NERC states that the Commission-directed language inadvertently and inappropriately excludes the word “not” for each violation severity level. NERC believes the language intended should be, for example, “[t]he applicable entity did not operate or direct the operation of capacitive and inductive reactive resources or load shedding within its area, as directed by the requirement, affecting 5 percent or less of the required resources.”

74. The Commission agrees with NERC and accepts NERC’s proposal to insert the word “not” as NERC indicates for each violation severity level in VAR-001-1, Requirement R8.

G. NERC’s July 21, 2008 Compliance Filing

75. In the VSL Order, the Commission directed specific revisions to 20 requirements corresponding to five Reliability Standards.³⁹ In compliance with the Commission directive, NERC submitted the revisions indicated in the Appendix to the VSL Order.

76. The Commission accepts NERC’s July 21, 2008 compliance filing. As discussed above, the Commission grants NERC’s requests for rehearing on certain matters regarding the violation severity levels in the VSL Order. Accordingly, the Commission directs NERC to submit a further compliance filing, within 30 days of the date of this order, consistent with the Commission determination in section III. E of this order.⁴⁰

The Commission orders:

(A) NERC’s request for rehearing and clarification is hereby granted in part and denied in part, as discussed in the body of this order.

³⁹ VSL Order, 123 FERC ¶ 61,284 at P 40.

⁴⁰ NERC notes that the Commission-directed revisions to the violation severity level assignments for IRO-006-3, Requirement R6 mistakenly reference four Interchange Scheduling Reliability Standards when there are only three approved standards (INT-001-2, INT-003-2, and INT-004-2). The Commission agrees and NERC should correct this in its compliance filing due in 30 days by designating N/A to the lower violation severity level; non-compliance with 1 of the 3 INT Reliability Standards, a moderate violation severity level; non-compliance with 2 of the 3 INT Reliability Standards, a high violation severity level; and non-compliance with all 3 INT Reliability Standards, a severe violation severity level.

(B) EEI's request for clarification is hereby granted, as discussed in the body of this order.

(C) NERC is hereby directed to include both historical compliance data and 2008 compliance data in its Guideline 1 analysis, as discussed in the body of this order.

(D) The deadline for NERC's compliance filing of the historical/2008 compliance report and the Guideline 2b, 3, and 4 review is hereby extended to September 18, 2009, as discussed in the body of this order.

(E) NERC's July 21, 2008 compliance filing is hereby accepted, as discussed in the body of this order.

(F) NERC is hereby directed to submit a compliance filing within 30 days as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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