

December 20, 2010

FERC Addresses Status of Federal Entities Under Reliability Rules

In an order issued on December 16, 2010, the Federal Energy Regulatory Commission (FERC) affirmed that federal entities are subject to the North American Electric Reliability Corporation (NERC) Reliability Standards. At the same time, FERC declined to rule whether it could enforce monetary penalties against federal entities in the event of violations of the Reliability Standards. While FERC's action is consistent with prior rulings in this area, the December 16 order differs in that FERC provides a roadmap for what federal entities must do to fund reliability compliance efforts, thus opening the door to the possible future imposition of monetary fines against them.

Background

NERC, the FERC-approved Electric Reliability Organization (ERO) for the United States electric grid, is charged with developing and enforcing Reliability Standards that are applicable to users, owners and operators of the Bulk-Power System. NERC has delegated its enforcement authority to the eight Regional Entities. Any penalty assessment made by NERC or a Regional Entity for a Reliability Standard violation must be submitted to FERC, via a Notice of Penalty (NOP) filing, for review and approval.

At issue in the December 16 order in Docket No. NP10-160-000, *North American Electric Reliability Corp.*, 133 FERC ¶ 61,214 (2010), was a NOP submitted by NERC proposing a zero dollar (\$0) penalty against the Army Corps of Engineers, Tulsa District (the Corps) for alleged violations of the Reliability Standards. The Corps requested FERC's review of the NOP, specifically seeking reversal of FERC's previous determination that the Reliability Standards apply to federal entities or, alternatively, affirmation that federal entities are not subject to monetary penalties for Reliability Standard violations.

Prior FERC Ruling on Jurisdiction over Federal Entities

In 2009, FERC determined that it has jurisdiction over federal entities to enforce the Reliability Standards. In that proceeding, which addressed another NOP proposing a \$0 penalty against the Corps for a Reliability Standard violation, FERC concluded that federal entities must comply with the Reliability Standards if they use, own, or operate the Bulk-Power System. FERC rejected the Corps' sovereign immunity arguments based largely on the statutory text: Section 215(b)(1) of the Federal Power Act (FPA) requires that "[a]ll users, owners and operators of the Bulk-Power System shall comply with [FERC-approved] reliability standards." No exception is made for federal entities. Although federal entities are generally exempt from the full panoply of FERC public utility regulation, FPA Section 201(f) specifically subjects them to the reliability requirements of Section 215. Additionally, FERC found that jurisdictional authority over federal entities was necessary to prevent a "significant gap" in reliability oversight.

Affirmation of Reliability Authority over Federal Entities

In the 2010 proceedings leading up to the December 16 order, the Corps sought a reversal of FERC's 2009 interpretation of Section 215 as applicable to federal entities. In addition to its sovereign immunity arguments, the Corps claimed that it was exempt from FERC's reliability authority because

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FERC lacked authority under the general civil penalty provisions of the FPA to impose penalties on federal entities and that the lack of a specific definition for the term “penalty” created an ambiguity that should be resolved in its favor. The Corps also argued that the Anti-Deficiency Act, which prohibits expenditures by federal entities like the Corps that exceed amounts available to cover the expenditures, limited FERC’s authority.

In the December 16 order, FERC again rejected the Corps’ argument that sovereign immunity generally and FPA Section 201(f) specifically exempt the Corps from FERC’s reliability authority. FERC reiterated its conclusion from the 2009 proceedings, finding that FPA Section 215’s specific reference to “**all** users, owners and operators of the Bulk-Power System” includes federal entities. While not expressly citing the legislative history relied upon in its 2009 ruling, FERC also noted the need to subject all such users, owners and operators to Section 215 to ensure reliability. Finally, FERC rejected the Corps’ Anti-Deficiency Act argument, explaining that Congressional appropriations did not override Section 215’s explicit grant of reliability jurisdiction to FERC.

Monetary Penalties

Like its prior ruling, FERC also declined in the December 16 order to rule on whether FERC has the authority to assess monetary penalties for Reliability Standard violations against federal entities. FERC determined that the issue was “not presented” for decision because no penalties had been assessed in this case – though FERC’s review and approval of the NERC-assessed “zero-dollar penalties” surely suggest otherwise. FERC also concluded that NERC had not “assumed” penalty authority merely because of the possibility that the violations at issue could constitute potentially aggravating factors in determining penalties for future violations.

Significantly, FERC suggested several means by which federal entities could pay monetary penalties in the event they are assessed. The Corps had argued that FERC and NERC could not mandate compliance with the Reliability Standards because the Corps relied on Congressional appropriations and therefore payment of penalties for any violations would run afoul of the Anti-Deficiency Act. FERC responded that the Anti-Deficiency Act does not prohibit the Corps from making expenditures to comply with the Reliability Standards “if the funds are available from existing appropriations or other revenue sources.” FERC acknowledged the potential limitations imposed by the Anti-Deficiency Act, but concluded that a federal entity lacking funds for compliance efforts could request the funding in “the budgeting and appropriations process going forward” (and indeed, FERC cautioned that it “see[s] no justification for failing to request such funds if they are needed to ensure reliable operation of Bulk-Power System facilities”). The federal entity also could seek an extension from NERC or FERC “to achieve compliance in appropriate circumstances.”

Implications

FERC’s decision on the extent of its reliability jurisdiction is unsurprising; it follows both the text of the governing statute as well as its prior ruling on this issue. But the December 16 order also provides a roadmap for what federal entities must do to achieve reliability compliance, which presumably includes the payment of potential monetary penalties for reliability violations: use “existing appropriations,” use funds from “other revenue sources,” seek additional funding, or request an extension. Penalties for reliability violations can be substantial (with six-figure penalties not uncommon). The open-ended nature

of FERC's statement about sources of funding (" . . . or other revenue sources") suggests that FERC may not consider a lack of appropriated funds to be a mitigating factor when assessing a penalty amount and raises a "red flag" about the source of funds to cover monetary penalties. If funds are not available through the appropriations process to cover monetary penalties, those with power purchase contracts with federal entities like the Corps (e.g., electric cooperatives and municipal utilities) and entities downstream of such contracting parties should review their contracts to ensure that these contracts do not become the "other revenue sources" to which FERC alludes.

Plainly, FERC remains firmly rooted in its expectation of full compliance by all users, owners and operators of the Bulk-Power System, and in its expectation that they will marshal the necessary resources to achieve compliance. While FERC has yet to directly address whether it has the authority to assess monetary penalties against federal entities for their failure to achieve compliance, the December 16 order outlines ways in which federal entities could request or otherwise collect funds to pay imposed penalties. Who in fact will provide such funds if they are not available through the normal budgeting and appropriations process remains to be seen.



If you have any questions about this Legal Alert, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

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