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LEGAL ALERT

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Federal Entities Face Monetary Penalties for Reliability Standards Violations

Federal entities, such as power marketing administrations (PMAs) like the Southwestern Power Administration (SWPA), may be assessed monetary penalties for violating the North American Electric Reliability Corporation's (NERC) Reliability Standards, according to the Federal Energy Regulatory Commission (FERC). In a July 19, 2012 order, FERC affirmed a $19,500 penalty against SWPA, finding that SWPA and other PMAs are not exempt from penalties under the mandatory and enforceable Reliability Standards. Although the penalty against SWPA is relatively modest, the long-term implications for the PMAs, other federal entities and the wholesale customers who purchase power from them remain unclear.

Background

FERC previously had determined that federal entities that use, own or operate the bulk-power system must comply with the Reliability Standards and are subject to FERC's jurisdiction to enforce the Reliability Standards. (See Sutherland's December 20, 2010 Legal Alert.) But because NERC had not previously imposed any monetary penalties, FERC skirted the issue of whether federal entities could be assessed monetary penalties.

As a result of NERC's $19,500 penalty against SWPA for violating two Reliability Standards, FERC was directly confronted with this issue. SWPA is one of four PMAs and markets its services primarily to "preference" customers, including electric cooperatives and municipal utilities. SWPA petitioned FERC to review the penalty on a single ground—whether NERC is authorized to assess a monetary fine against a federal entity.

The July 19 Order

In its July 19 order, FERC answered yes. In determining that federal entities are subject to monetary penalties for violating the Reliability Standards, FERC relied on the plain language of section 215 of the Federal Power Act (FPA). Section 215 establishes NERC's authority to impose penalties for violations of the Reliability Standards (subject to FERC review) and applies to all users, owners and operators of the bulk-power system—without any exemption for federal entities. FERC also cited congressional intent as supporting broad applicability for section 215 penalties.

FERC rejected arguments that the general civil penalty provision of the FPA—section 316A—limits the imposition of penalties on federal entities under section 215. Section 316A authorizes civil penalties under the FPA of up to $1 million per day per violation. Penalties under section 316A may be imposed only upon a "person," which the FPA defines as an "individual or corporation," and which excludes the PMAs. FERC found that section 316A merely informs what constitutes an appropriate sanction imposed under section 215 for a violation of the Reliability Standards. Penalties assessed under section 215 are subject to the section 316A cap, but section 316A does not limit NERC's ability to impose section 215 penalties. Thus, section 215 provides its own enforcement and penalty regime independent of section 316A.

FERC also dismissed public policy arguments made by SWPA and its supporters. FERC found that imposing monetary penalties on federal entities would not be a "waste" of federal resources, because exempting federal entities from penalties would undermine NERC's "enforcement regime," which is an

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"integral part" of ensuring reliability. FERC also surmised that, like other consumer-owned entities subject to reliability penalties, federal entities will have a strong incentive to develop a culture of compliance to avoid monetary penalties, whether in response to congressional or presidential oversight or to address customer concerns. FERC concluded that subjecting federal entities like the PMAs to reliability penalties would not frustrate their statutory mission to provide low-cost power from federally-owned hydroelectric generating projects.

Finally, FERC found that the federal Ant-Deficiency Act, which generally limits federal expenditures to amounts available in appropriations or funds, did not preclude imposition of the penalties. Instead, penalties could be recouped from PMA customers or treated as "necessary expenses" to which the limitations of the Anti-Deficiency Act do not apply.

What This Means for Industry Participants

As indicated by FERC Chairman Jon Wellinghoff's remarks on the issuance of the July 19 order, the legal battle over the imposition of reliability penalties on federal entities is far from over. FERC appears to be on solid legal ground in concluding that the enforcement provisions of section 215 "unambiguously" and "unequivocally" apply to the PMAs. But FERC's order will likely be appealed to the federal courts.

Objection to FERC's conclusion in part turns on weighty issues such as the waiver of sovereign immunity and the ability of one federal agency (FERC) to impose penalties on another (the Department of Energy's SWPA). But equally important is the more mundane issue of who will pay for the penalties that are imposed on PMAs. FERC noted in the July 19 order that the PMAs could pass on the costs of penalties to their preference customers who rely on access to lower-cost federal hydroelectric power. FERC seemingly dismissed the concerns of PMA customers over these pass-throughs when it concluded that PMA customer access to lower-cost federal power is "not affected" by FERC's decision. While the $19,500 penalty at issue in the July 19 order is relatively small, the pass-through concern is not unfounded, at least with respect to future cases that could involve more significant penalties (potentially in the six-figure range). As a result, the July 19 order provides some certainty on the issue of imposing reliability penalties on federal entities, but fails to address the issue of who will ultimately pay for these penalties.

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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