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Regulators should carefully consider size and scope of penalties for accidents

By Max Minzner, former Special Counsel to the Director of Enforcement at the Federal Energy Regulatory Commission

Whenever there is a tragedy, be it in a coal mine, on a drilling platform, or in your neighborhood, there is an understandable desire to learn the cause and penalize the perpetrator. In many cases, regulatory agencies must decide the appropriate penalty. Accidents like the Massey coal mine tragedy, the Enbridge Pipeline oil spill, the Arkansas oil pipeline failure, and gas pipeline explosions like those in Allentown, Sissonville, and San Bruno, all have resulted in significant fines and penalties.

Serious penalties are appropriate in serious cases and the 2010 San Bruno, Calif. pipeline explosion certainly qualifies. The tragedy destroyed more than 35 homes; eight people lost their lives. It might at first seem that no penalty is too high in a case like this and, in connection with the accident, the California Public Utilities Commission is considering a record \$4 billion fine against Pacific Gas and Electric Company, the owner and operator of the pipe that exploded.

However, \$4 billion would represent by far the largest civil penalty imposed in this type of case. That's 160 times the penalty imposed on the company responsible for the 2011 Allentown explosion, in which five people died (\$25 million) and about 40 times the penalty in the Carlsbad disaster in 2000 that killed 12 people (\$101 million).

Civil penalties imposed by regulators like the CPUC against regulated entities like PG&E have a single purpose: deterrence. These penalties need to be large enough so that complying with regulations is less expensive than breaking the law. Penalties should be calculated carefully to ensure they are of the correct size and scope, and in order to determine these, regulators and enforcement agencies need to ask the right questions. Did the company earn significant financial gains from the violation or were the benefits more modest? Did the company seriously attempt to comply or were its compliance efforts limited or non-existent? Large civil penalties are appropriate for highly lucrative violations where the company made no effort at compliance. Smaller penalties are sufficient when the company tried seriously to comply or when the gains from the misconduct are small.

CPUC does not appear to have done this work. Instead of a penalty calculated on deterrence, the CPUC

is recommending a penalty based on what it thinks PG&E can afford to pay. Regulators want the companies they regulate to spend resources to protect the public and serve a public interest while complying with rules designed to enforce these notions. But if the penalty in cases like this no longer depends upon compliance efforts – that is, if instead it simply is a function of the regulated entity’s ability to pay – the public ultimately loses. In this scenario, companies no longer have an incentive to spend money on compliance, since compliance no longer alters the outcome.

Moreover, deterrence is only attained if regulators and enforcers clearly explain how they calculate penalties. Indeed the CPUC should be trying to send a message about those violations which it cares most about preventing and to do so, it should disclose what conduct will move a penalty higher or lower, and which facts will increase or reduce a penalty. Instead of adhering to this important principle of deterrence – one embraced by other enforcement agencies including its parallel federal regulator, the Federal Energy Regulatory Commission – the CPUC has not clearly explained which violations will produce penalties in the millions, like the \$16 million penalty it imposed in the 2007 San Diego wildfires that killed seven, and those which produce penalties in the billions.

Regulators and enforcers cannot expect regulated companies to hear a message that is not conveyed. Without calculating penalties transparently and correctly, the CPUC ultimately will not achieve its goals of deterrence, setting a dangerous precedent for California and the rest of the nation. Big penalties draw big headlines, but lose their meaning when they cannot shape behavior. The CPUC should think carefully about how it reaches its final penalty figure in order to achieve its deterrence goals.

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