

such an attribution and direct assignment, it proposed to allocate the costs of a penalty to all tariff customers based on their level of transmission usage or market participation.

On May 31, 2007, the Commission rejected the Midwest ISO tariff changes without prejudice, finding that the Midwest ISO had not justified its proposal.¹ The Commission explained that, while it has recognized that the organizational structure and financial model of ISOs and RTOs may present unique circumstances for compliance with and enforcement of reliability standards, it did not intend that Section 205 filings initiated by ISOs and RTOs to recover penalty costs would involve new, additional investigations or violations of reliability standards beyond any investigations done in the initial assessment of penalties.² The Commission found that the Midwest ISO's proposal raised a number of issues that should be explored in a Staff technical conference, which was subsequently convened on September 18, 2007. As the Electric Reliability Organization ("ERO") certified by the Commission, NERC participated in the technical conference, and hereby submits these comments on issues raised at the technical conference and in the written comments of the Midwest ISO and the IRC.

II. COMMENTS

A. **RTOs and ISOs Should Not Have the Authority to Determine that RTO and ISO Members Have Violated Reliability Standards, Independent of Determinations Made by NERC and Regional Entities Through the Commission-Approved Compliance Enforcement Process.**

NERC does not disagree with the proposition that non-profit ISOs and RTOs, which do not have earnings or retained earnings from which they could pay monetary penalties, should

¹ *Midwest Independent Transmission System Operator, Inc., et al.*, 119 FERC ¶ 61,222 (2007) ("May 31 Order").

² *See id.* at P 24.

have a funding mechanism to recover from their members the costs of monetary penalties,³ and NERC recognizes the Commission has indicated that it will allow ISOs and RTOs to propose such a mechanism in a Section 205 filing.⁴ This issue is by no means unique to ISOs and RTOs; there are many other owners, operators and users of the bulk power system subject to NERC reliability standards that are non-profit entities (*e.g.*, generation and transmission cooperatives).⁵ NERC takes no position on how such a recovery mechanism should be effectuated, *so long as* it does not involve the ISO or RTO assessing responsibility to third parties for violating reliability standards. That function is the exclusive function of NERC and (through Commission-approved delegations of authority) the Regional Entities, pursuant to the NERC/Regional Entity Compliance Monitoring and Enforcement Program (“CMEP”), including its hearing procedures, and subject to right of appeal to and (in any event) confirmation by the Commission.

NERC is concerned by the Direct Assignment aspect of the Midwest ISO’s proposal insofar as it would give the Midwest ISO authority to compile evidence and make a case before the Commission that violations attributed to the Midwest ISO in a reliability function (presumably as found by a Regional Entity through the CMEP processes, including any hearing, and then confirmed by NERC and ultimately by the Commission) are in fact “attributable to the

³ As NERC’s Executive Vice President, David Whiteley, explained at the technical conference, “NERC and the regional entities do not have an interest in how the ISO or RTO funds or recover those penalties.” *See* Tech. Conf. Tr. at p. 115:14-16.

⁴ *See* Order No. 672-A at P 58.

⁵ It is unavoidable by definition that a not-for-profit entity that is assessed a monetary penalty for violation of a reliability standard must recover the cost of paying the penalty from its members/users, whether through a current tariff charge adjustment mechanism or an incremental cost recovery in a future tariff. While this situation on its face may be viewed as ameliorating the deterrent effect of monetary penalties on such not-for-profit entities, presumably if the members/users of the entity are assessed for what they view as an excessive amount of penalty costs over time, they will use the governance or other processes available to them to effectuate appropriate change at the not-for-profit entity.

conduct” of another entity.⁶ Presumably, only when the Commission is satisfied that Midwest ISO has made a sufficient case will it approve the “assignment” of the penalty costs to the other entity. Because a determination of fault is the basis for the assignment, the reach of such a proposal extends beyond mere cost allocation, and would permit an ISO or RTO to stand in the shoes of the ERO and Regional Entities and assign fault for the violation of a reliability standard.

An RTO or ISO that a Regional Entity or the ERO has found (through the Commission-approved compliance enforcement processes) violated a reliability standard, and which has been assessed a monetary penalty by the Regional Entity or the ERO, should not be permitted to make a determination that third parties violated the reliability standard and must bear the cost of the monetary penalty, independent of any such determination made by the Regional Entity or the ERO. Providing such authority to an RTO or ISO would be inconsistent with Section 215 of the Federal Power Act (“FPA”), which authorizes only the ERO certified by the Commission, and Regional Entities delegated authority by the ERO (as approved by the Commission), to make determinations (pursuant to ERO and Regional Entity rules the Commission has approved) that reliability standards have been violated and to impose penalties and sanctions on the entities determined by the ERO or Regional Entity to have violated the standards. There is no provision in the FPA for other entities such as ISO or RTO to make such determinations or to impose penalties on entities independent of any such determinations made by the ERO or Regional Entity.⁷ Further, as the Commission knows, NERC, the Regional Entities, the Commission and numerous interested entities have devoted considerable time and effort to developing a CMEP and hearing procedures to be used by the ERO and Regional Entities in making determinations

⁶ See Midwest ISO Electric Tariff Filing on Schedule 10 Pass-Through of Electric Reliability Organization Penalties, Docket No. ER07-701-000, Transmittal Letter at p. 5 (Apr. 2, 2007).

⁷ See FPA § 215(e)(4).

of noncompliance with reliability standards that afford appropriate due process to users, owners and operators of the bulk power system and are comprehensive and fair.⁸

To be clear, NERC would not be concerned about a Direct Assignment proposal if the direct assignment to a particular entity of the costs of a monetary penalty imposed on an RTO or ISO were based on a determination made in the Regional Entity or ERO compliance enforcement process or hearing that the entity assigned responsibility for the costs was responsible (in whole or in part) for the violation of the reliability standard or the actions that resulted in the violation. In this way the determination of responsibility for violation of the reliability standard would be made by the entities assigned this function by Congress and the Commission, not through a redundant process by an entity (the RTO or ISO) that was not given this statutory function.

As explained by the Midwest Reliability Organization at the technical conference, the necessary rules, structure, and due process are in place to assure that the reliability standards are fairly applied to non-profit entities such as ISOs or RTOs.⁹ Further, where monetary penalties are considered for an entity's violation of a reliability standard, the NERC Sanction Guidelines (Appendix 4B to the NERC Rules of Procedure) specifically contemplate that the amount of the penalty may reflect the entity's ability to pay, including whether the entity has a for-profit or non-profit structure.¹⁰ Nor is the argument of "independence" a valid consideration. Other registered entities have independent boards or must comply with strict governance rules imposed by other regulatory bodies. In the final analysis, however, the threshold for application of the

⁸ On October 30, 2007, NERC made a compliance filing in Docket Nos. RR06-1-012, *et al.* submitting its revised uniform CMEP and hearing procedures in response to directives in an Order issued by the Commission on April 19, 2007.

⁹ *See* Tech. Conf. Tr. at p. 130:15-131:10.

¹⁰ *See Sanction Guidelines of the North American Electric Reliability Corporation*, section 3.11, pp. 5-6 (effective October 18, 2007).

standards and their enforcement must be the impact on reliability, not the tax status of the registered entity.¹¹

There appears to be a concern, however, embedded in the Midwest ISO Direct Assignment proposal about how certain standards will be enforced against entities that do not own assets.¹² Midwest ISO's representative suggested an example of how the ERO and Regional Entities might miss the true "cost causer" in the context of the BAL series of standards:

...[I]f MISO is the balancing authority once it begins operating the ancillary services market, but the entity that actually caused the standard to be violated was one or more generation companies, the generation operator isn't even a functional entity that's responsible for compliance with that standard. The balancing authority is, but it might be their actions that were the reason that MISO could not comply with the balancing authority control performance standards. So that's where the rub is and that's where you really need the regional entity investigation. And it's probably stretching the regional entity's scope of their investigation beyond what they originally contemplated because it is getting functional entities involved who are not actually the entities responsible for compliance with the standard.¹³

NERC submits there are many entities that do not own all the assets that they may be responsible for under the Reliability Standards. This is not an issue unique to RTOs and ISOs. Many Balancing Authorities, for example, do not own all of the generation within their Balancing Authority area. There are load-serving entities that do not own physical assets, yet are

¹¹ In Order 672-A, the Commission explained that "we do not believe that Congress enacted a law that provided for Reliability Standards to be enforceable through penalties and neglected to mention that it intended to exempt system operators that operate the Bulk-Power System serving half or more of the electric load in the United States...we will not by rule exempt these large and important system operators from monetary penalties for violation of Reliability Standards." *See* Order No. 672-A at P 57.

¹² *See e.g.*, Comments of the ISO/RTO Council, Docket No. AD07-12-000 ((Oct. 2, 2007) ("IRC Comments") at p. 6 ("the questions raised at the Technical Conference with regard to root cause analysis for Balancing Authority compliance are also applicable for other issues involving the relationship between entities "operating" assets and those entities that "own" assets").

¹³ *See* Tech. Conf. Tr. at p. 109:13-110:2.

responsible for the reliable supply of electricity to end-use customers. The authority to determine which entities must comply with a given reliability standard is a matter that has been delegated to the ERO and Regional Entities through the reliability standard development process, and these types of concerns should be raised there. In fact, the Commission has already addressed this issue with respect to RTOs and ISOs and confirmed that it must be addressed in the Reliability Standards process. Specifically, in Order No. 672, the Commission stated that while it “generally agrees that entities should not be punished for violations that are not within their control,” it would not make a generic ruling on this issue for all RTOs and ISOs. Instead, the Commission explained, RTOs and ISOs could “raise these concerns with the ERO’s or a Regional Entity’s stakeholder process if it believes that a proposed Reliability Standard would make an RTO or ISO responsible for an action or occurrence outside its control.”¹⁴

For all of these reasons, adoption of the MISO direct assignment proposal would not be good policy.

B. The ERO and Regional Entity Compliance Enforcement Processes Can Be Expected to Identify the Entity or Entities Whose Actions Were the Cause of the Reliability Standard Violation

NERC believes the need for the separate Section 205 proceeding for a Direct Assignment of penalty costs, as proposed by MISO, has not been demonstrated at this time. The premise underlying the need for such a mechanism is that the ERO and Regional Entity compliance enforcement processes will not result in identification of the entity whose actions (or inactions) were responsible (in whole or in part) for the violation of the reliability standard in question, and that the ISO will be tagged with the violation and monetary penalty without the Regional

¹⁴ Order No. 672 at P 636.

Entity/ERO process having identified the real responsible entity – thereby necessitating a separate process to be conducted by the ISO. NERC believes this premise is invalid.

The compliance monitoring and enforcement processes the Regional Entities and NERC will use, as embodied in the NERC uniform CMEP, are very thorough (and, in their revised, current versions as filed with the Commission in NERC’s October 30, 2007 compliance filing, incorporate many specific Commission directives for improvement). Any finding of a violation of a reliability standard will originate in facts found through one of the eight compliance monitoring processes established in the CMEP, including compliance audits, compliance violation investigations, self-reporting, exception reporting and periodic data submittals. Further, where the entity receiving a notice of Alleged Violation requests a hearing, the NERC and Regional Entity hearing procedures provide for a full, due process evidentiary hearing. A determination of Confirmed Violation in the Regional Entity hearing process may be appealed to NERC, and then to the Commission.¹⁵ NERC submits that the presumption (unless and until proven inaccurate) should be that these detailed investigative, hearing and appeal processes will result in identification of (all of) the entities whose actions caused or contributed to a reliability standard violation.

At the technical conference and in its comments, the Midwest ISO suggested that the Direct Assignment proposal is justified by the “hypothetical, but nevertheless possible, scenario in which the ERO only sees a violation, but the Midwest ISO has evidence that the violation was

¹⁵ If assessed a penalty by a Regional Entity for violation of a reliability standard, the Midwest ISO or any other entity may raise to the ERO, and then to Commission, any arguments and submit any evidence it may have with respect to the entity it believes was responsible for the reliability standard violation.

caused by actions of a specific entity.”¹⁶ The IRC similarly stated that the ERO or Regional Entities must “drill down” to find the “root causes” of a reliability standard violation. It is unwarranted, however, to suggest or presume that the Regional Entities and NERC will not identify the root cause of a violation.¹⁷ While NERC’s representative at the technical conference did correctly note that NERC will not be able to determine the proportion of parties’ culpability for violating standards to the percentage point and that RTOs as registered entities would be liable for penalties that apply to the functions for which they are registered, the NERC representative also clearly explained that the ERO would examine the “root cause” of a violation:

NERC and the Regional Entities will investigate the root cause of a violation and extend that investigation to entities not on the compliancy registry if necessary. If an entity is not included in the compliance registry it may still be included in any compliance investigation and may be added to the registry pending the outcome of the investigation. In the case the entity must also submit a mitigation plan to the Regional Entity and NERC to resolve the violation.¹⁸

The Regional Entity representatives at the conference echoed these comments, confirming their commitments to both thoroughness and due process in the compliance monitoring and enforcement processes and including the compliance violation proceedings. NERC reiterates that it and the Regional Entities will ensure a thorough investigation and all entities involved in the matter under investigation will be identified. In the event an entity violated a standard or requirement of a standard and was not registered, the Regional Entity will register the entity and require a mitigation plan and the newly registered entity will be subject to any enforcement resulting from any subsequent violations. If there are contributing factors, including other entities’ actions or inactions that impact the violation of the responsible

¹⁶ See Comments of the Midwest Independent Transmission System Operator, Inc., Docket No. AD07-12-000, at p. 5 (Oct. 2, 2007) (“Midwest ISO Comments”).

¹⁷ See Midwest ISO Comments at p. 5; IRC Comments at p. 5.

¹⁸ Technical Conference Tr. at p. 119:4-120:7.

registered entity, those will be considered during the enforcement processes, the determination of the penalty assessment, and the review and approval of a mitigation plan.

An RTO or ISO, of course, has an obligation to be proactive in sharing information with the compliance enforcement authority (a Regional Entity or NERC) and assisting it in gathering facts that will lead to the determination of the entity or entities responsible for the reliability standard violation. In fact, for at least some reliability standards, the RTO or ISO may be the entity best able to access and provide information to the Regional Entity or NERC concerning the underlying cause of a violation and the entity or entities whose actions or inactions resulted in the violation. This is true both at the compliance monitoring stage (*e.g.*, during a compliance violation investigation or compliance audit) or during the Regional Entity hearing process.

C. RTOs and ISOs Can Take Advantage of the Joint Registration Process Now Embodied in NERC’s Rules of Procedure

Finally, NERC notes that RTOs and ISOs have the ability to utilize the joint registration provisions in Sections 501 and 507 of the NERC Rules of Procedure to establish which members of the RTO or ISO are responsible for compliance with particular reliability standards or requirements of reliability standards.¹⁹ As provided in Section 501.1.2.7(a), “a JRO [Joint Registration Organization] and its members or related entities may enter into a written agreement as to which of them will be responsible for one or more reliability standards applicable to a particular function and/or for one or more requirements within particular reliability standards applicable to a particular function and/or for one or more requirements within particular reliability standards, in either case in accordance with the provisions specified in Section 507.” Section 507.2, “Joint registration pursuant to written agreement,” provides that

¹⁹ These provisions of the NERC Rules of Procedure were approved by the Commission in an Order issued July 19, 2007 in Docket No. RM06-16-003. *Order on Joint Registration Organization Filing*, 120 FERC ¶61,065 (2007).

Where a JRO and any of its members or related entities agree, in writing, upon a division of compliance responsibility among them for one or more reliability standard(s) applicable to a particular function, and/or for one or more requirements within particular reliability standard(s), both the JRO and such member(s) or related entit(ies) shall register as an organization responsible for that function. The JRO and its member(s) or related entit(ies) must have a written agreement that clearly specifies their respective responsibilities, which shall be submitted as part of the joint registration.

Negotiation and submission of joint registration agreements pursuant to Sections 501 and 507 can help to avoid situations of the type that appear to concern MISO, by establishing responsibilities between and among the RTO or ISO and its members or users for compliance with the requirements of particular reliability standards and for specific requirements within reliability standards. Such agreed assignments of responsibility can in turn facilitate identifying the entity or entities that were responsible for a violation of the reliability standard and that should bear financial responsibility for any monetary penalty that is assessed.

III. CONCLUSION

NERC thanks the Commission for the opportunity to participate and respectfully requests that the Commission consider these comments as it goes forward in these proceedings.

Respectfully submitted,

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November 6, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 6th day of November, 2007.

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