

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Reliability Standard Compliance and)	
Enforcement in Regions with)	Docket No. AD07-12-000
Independent System Operators and)	
Regional Transmission Organizations)	
)	

COMMENTS OF THE ISO/RTO COUNCIL

The ISO/RTO Council (“IRC”)¹ respectfully submits these joint comments regarding the technical conference held by Commission staff on September 18, 2007 (“Technical Conference”).

I. BACKGROUND

The Commission has noted in multiple orders that Independent System Operators (“ISOs”) and Regional Transmission Operators (“RTOs”) have unique characteristics that should be taken into account when determining what sort of penalty should be assessed in the event of a reliability standards violation. The Commission staff convened a technical conference on September 18, 2007 to receive input regarding the role of penalties in regions with ISOs and RTOs and sought input from ISOs, RTOs, electric industry participants, as well as the Electric Reliability Organization (“ERO”) and regional entities. During the technical conference, Commission staff

¹ The IRC is comprised of the Independent System Operator operating as the Alberta Electric System Operator (“AESO”), the California Independent System Operator Corporation (“CAISO”), Electric Reliability Council of Texas (“ERCOT”), the Independent Electricity System Operator of Ontario (“IESO”), ISO New England Inc. (“ISO-NE”), Midwest Independent Transmission System Operator, Inc. (“MISO”), New York Independent System Operator, Inc. (“NYISO”), PJM Interconnection, L.L.C. (“PJM”) Southwest Power Pool, Inc. (“SPP”) and New Brunswick System Operator (“NBSO”). The IESO, AESO and NBSO are not subject to the Commission’s jurisdiction including the obligation to pay any penalties and their endorsement of these comments does not constitute agreement or acknowledgement that either can be subject to the Commission’s jurisdiction. The IRC’s mission is to work collaboratively to develop effective processes, tools and standard methods for improving competitive electricity markets across North America. In fulfilling this mission, it is the IRC’s goal to provide a perspective that balances reliability standards with market practices so that each complements the other, thereby resulting in efficient, robust markets that provide competitive and reliable service to customers.

invited comments on the conference to be submitted within the two weeks following the conference.

II. COMMENTS

A. **Comments Provided by Representatives of NERC and Regional Entities at the Technical Conference Fail to Recognize the Unique Position of RTOs and ISOs and the Commission’s Policy Statements Regarding that Position**

The IRC is concerned that the in-person testimony presented on behalf of the North American Electric Reliability Corporation (“NERC”) and comments made on behalf of Regional Entities at the Technical Conference did not reflect the state of the law as reflected in Commission precedent on this very topic. The Commission has been faced with the generic issue of the appropriate level of penalties to be assessed against an RTO/ISO and provided clear direction to the ERO that the unique characteristics of ISOs and RTOs should be taken into account by the ERO and Regional Entities when contemplating the application of penalties for those organizations in the event of a reliability standard violation. *See* Order No. 672-A at P 56. Moreover, the Commission indicated that it will address the appropriateness of the levying of a financial penalty on an RTO or ISO on a case by case basis. *See* Order No. 672 at PP 634-35.

The in-person testimony presented on behalf of NERC and the Regional Entities taken as a whole seems to express a view that ISOs and RTOs are no different than any other user, owner or operator of the bulk-power system for purposes of assessment of financial penalties and that monetary penalties should be applied without regard to RTO/ISO status or even fault for the underlying violation.

The IRC takes no issue with Mr. Whiteley’s prepared statement that “[i]f a violation of a standard is confirmed, a financial penalty could be levied against an ISO or RTO just as any other

registered entity.”² However, the positions presented at the Technical Conference by NERC and the Regional Entities during the panel discussion failed to reflect the policy directives regarding monetary penalties and their application to ISOs and RTOs provided by the Commission in authorizing NERC as the ERO and the fact that monetary penalties are simply one of several options made available by Congress for enforcement.

In Order 672-A, the Commission reiterated a finding it originally made in Order 672, succinctly stating:

The Commission acknowledged . . . the unique characteristics of ISOs and RTOs and agrees that in determining a penalty, circumstances such as organizational structure or non-profit status will be considered.³

More recently, in the order giving rise to the present Technical Conference, the Commission stated:

In Order Nos. 672 and 672-A, while declining to exempt non-profit ISOs and RTOs from penalties for violation of Reliability Standards, the Commission recognized that ISOs and RTOs have unique characteristics that the ERO or Regional Entity may take into consideration in determining an appropriate or effective sanction.”⁴

Thus, while ISOs and RTOs are certainly subject to penalties for violation of reliability standards, the Commission has determined that for ISOs and RTOs the characteristics of these organizations will factor into determining the most appropriate sanction for any violation, which may be a non-monetary sanction. NERC’s view that ISOs and RTOs are to be treated like any other user, owner or operator when considering the appropriateness of financial penalties appears to disregard the Commission’s directives to the ERO and Regional Entities.

NERC and the Regional Entities’ comments during the panel discussion stood in contrast

² Whiteley Prepared Statement at ¶ 3.

³ Order No. 672-A at P 56.

⁴ *Midwest Independent Transmission System Operator, Inc.*, 119 FERC ¶ 61,222 at P 22 (2007).

not only to the Commission's orders on the issue, but also to the panel discussions that preceded them. Both the ISO / RTO panel and the electric industry participant panel recognized that monetary penalties could be utilized with respect to ISOs and RTOs. The view of those panels, however, appeared to reflect some consensus that while the enforcement statute provides for monetary penalties, monetary penalties are just one option among several penalty types afforded by the statute, and non-monetary penalties make more sense in the case of non-profit, independent ISOs and RTOs where profit motive or pressure for shareholder returns simply does not exist and where operating expenses are largely funded by market participants.

B. The Record Reveals that the Necessary Adjustments, if any, for each RTO/ISO are Unique to Each RTO/ISO.

The Technical Conference was helpful to exploring the broader policy issues. As noted below, the Technical Conference revealed a fundamental difference in the approach to reliability violation analysis that virtually all of the participants were seeking vs. what was portrayed by the ERO and the Regional Entities as their present intentions. This issue is further addressed in Section C below.

The Commission should keep in mind, however that, this Technical Conference arose out of a specific request from the Midwest ISO which believes that absent a tariff change, it did not have the authority to appropriately allocate and collect ERO financial penalty charges.⁵ The record shows that PJM was working with its stakeholders on a proposal that would address necessary conforming changes to the PJM tariff to address liability and allocation issues in the context of the existing PJM tariff⁶ while California ISO indicated that it had authority to address WECC penalties

⁵ Tr. at p. 22:19 - p.23:2 (comments of Mr. Kozey).

⁶ *See, e.g.*, Tr. at p. at 33:6-13 (comments of Mr. Pincus).

but not necessarily ERO penalties consistently.⁷ Although the IRC urges the Commission to address the larger policy issues concerning the nature of the ERO's penalty assessment analysis, the Commission should, at the same time, allow individual filings (or prospective filings) to proceed to address the exposure and lack of clarity that might exist absent clarifying changes to any particular RTO/ISO's governing documents. These changes should be addressed on a case-by-case basis if the RTO/ISO makes such a filing, with the RTO/ISO justifying its proposal in light of its existing tariff or other governing documents and whatever changed circumstances resulting from the certification of the ERO and Regional Entities that might be relevant.

C. Penalizing Only the Registered Entity Regardless of Whether that Entity Caused a Violation Runs Contrary to the Energy Policy Act of 2005, and Does Not Further Reliability Compliance.

The IRC is concerned that the in-person testimony presented on behalf of NERC and the Regional Entities at the Technical Conference regarding assessment of any type of penalty only to the entity registered for a specific function or standard regardless of whether that entity actually caused the violation⁸ runs contrary to the language of the Energy Policy Act and will not result in improved reliability. The IRC urges the Commission to require the ERO to “drill down” and undertake a thorough and fair assessment of the causes of a given reliability violation while ensuring appropriate due process for all affected stakeholders. Such an approach is not only necessary to improve reliability by determining the root circumstances that require correction but also consistent with the Commission's own approach in the *Joint US-Canada Blackout Report*. In no event should NERC or the Regional Entities be constrained by whether or not any particular company has registered as a user, owner or operator, as no such constraint should exist as a matter of law or logic.

⁷ See Tr. at p. 44:8-13 (comments of Mr. Invancovich).

⁸ Technical Conference Transcript at p. 117:6-8; 133:25 – 134:7.

At the Technical Conference, an issue was raised where an ISO or RTO registered as a Balancing Authority. The discussion that followed explored the enforcement implications of a situation where an individual generator's or multiple generators' actions caused or contributed to a violation of Reliability Standards that apply to a Balancing Authority and explored the questions about which entity or entities would be held responsible. As discussed further below, 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.

NERC and the Regional Entity representatives expressed their view that for a Balancing Authority violation, the registered entity, *i.e.*, the ISO or RTO, would be held responsible and could be subject to a penalty even though that ISO or RTO had not caused the reliability standard to be violated. The NERC and Regional Entity panel was clear that it intended to apply penalties only to the entity registered for a given function *regardless* of whether that entity caused the violation. While the IRC understands the administrative ease of this approach, it appears to violate both the requirements of the Energy Policy Act which allows for enforcement against users, owners or operators that contributed to another entity being unable to comply with reliability standards requirement; and creates the impression of enforcement for enforcement sake without addressing root cause behavior – which is critical for promoting the reliable planning and operation of the bulk power systems of North America.⁹ Moreover, conducting root cause investigations will have the attendant benefit of eliminating duplicative hearings or litigation at the Commission to identify all responsible entities that will otherwise be necessary.

⁹ See Certificate of Incorporation of the North American Electric Reliability Corporation at p1 of 4.

The IRC, further, does not believe that “there is no way to quantify”¹⁰ the degree to which the root behavior of one entity contributed to the violation of a Reliability Standard that applies to another entity. Many Reliability Standard enforcement actions will involve more than one potential wrong-doer, and the ERO and the Regional Entities are indeed going to have to quantify proportionate contribution, in this and other circumstances.

The Energy Policy Act of 2005 states that the ERO may impose a penalty on a user, owner or operator of the bulk-power system for a violation of a reliability standard approved by the Commission if the ERO:

Finds that the user or owner or operator has violated a reliability standard approved by the Commission...¹¹

In addressing the formation of the ERO in Order No. 672, the Commission responded to concerns raised by ISOs and RTOs that pointed out that those entities, unlike vertically integrated utilities, operate assets *that they do not own*. The Commission stated the policy view that:

[W]e agree generally that entities should not be punished for violations that are not within their control.¹²

The Commission directed that those concerns should be raised within the reliability standards process. In Order No. 693, the Commission further clarified its view that the standards should be granular enough:

...so that the appropriate user, owner or operator of the Bulk Power System would be identified for each Reliability Standard.¹³

¹⁰ Transcript at 119:16-19 (comments of Mr. Whiteley)

¹¹ 16 U.S.C. § 824o(e)(1)(A).

¹² Order No. 672 at P 636.

¹³ Order No. 693 at P 141.

The Commission further stated in Order No. 693 that its goal was to ensure that there was neither overlap or gaps with regard to the reliability standards.¹⁴

Therefore, the Commission has endeavored in its rule making proceedings to direct NERC to improve its standards so that there is a regulatory scheme that connects standards with responsible entities – *i.e.*, those entities that may be the proximate causer of or contributor to a violation. IRC members are also working with companies in their regions to better identify the split of responsibilities for various standards.¹⁵ While the IRC strongly supports the goal of connecting responsible entities with Reliability Standards to the fullest extent possible, it is also clear at this juncture that it is possible that an entity “registered” for a given function may not in fact be the cause of or primary contributor to a violation of a reliability standard. While the Balancing Authority example was explored at the Technical Conference, others potential areas come readily to mind. For example, misoperations might occur due to asset owners not providing sufficiently accurate or timely information regarding the characteristics of their facilities – *e.g.*, inaccurate or outdated equipment ratings or capabilities. Alternatively, even a paperwork requirement might be violated by an ISO or RTO for a given function because an asset owning participant has failed to forward the necessary, or accurate, documents.

If reliability deficiencies are to be addressed and improved, the IRC submits that NERC should not deem a thorough investigation of root causation as unnecessary or irrelevant simply by

¹⁴ See Order No. 693 at PP141 – 145.

¹⁵ In this regard, the IRC respectfully submits that NERC’s establishment of a “Joint Registration Organization” should not be viewed as a “one size fits all” remedy to the issue of defining who bears liability with regard to every Standard requirement. This is particularly important given the lack of clarity about what forms the JRO may take. The Commission made abundantly clear in Order No. 693 that for ISOs and RTOs it did not intend to “change existing contracts, impose new organizational structures or otherwise affect existing agreements that set forth the responsibilities of various entities.” Order No. 593 at P 141. The Commission affirmed that its primary concern was to “ensure that there is neither [unnecessary] redundancy nor gap in responsibility for compliance with the Requirements of a Reliability Standard, while allowing entities flexibility to determine how best to accomplish this goal.” *Id.* at PP 143 & 145.

mechanically penalizing a registered entity where the registered entity may not have been the proximate cause of the violation.

NERC's prepared statement notes that NERC intends to investigate "entities not on the compliance registry if necessary" and notes that if an entity should have been registered for a registry and was not, it will add the entity.¹⁶ While the IRC supports NERC's statement to investigate beyond the registry to determine causation, it notes that NERC's efforts with respect to an unregistered but wrong-doing entity should not be limited to registering that entity going forward – which many times might not be appropriate – and thereby simply giving them a pass for current violations. Returning to the Balancing Authority example, generator actions or inactions that might be found to be the root cause of the violation in the hypothetical discussed at the Technical Conference cannot and should not be "cured" by simply registering generators as Balancing Authorities. Such an approach would simply cause more confusion and would mix the Balancing Authority role with the reality that actions of non-balancing authorities can have an impact on the Balancing Authority's ability to meet a reliability standard.¹⁷ In short, just adding additional persons to the registry is not the remedy for the problem of appropriately assessing penalties on the entity causing or contributing to a Standard violation. NERC's proposed remedy confuses the role of a registered entity with the need for NERC and the Regional Entities to recognize and act upon the fact that other entities can cause or contribute to a registered entity violating a reliability standard. Reliability Standards need to be improved to capture the "root" actions of asset owners, and NERC and the Regional Entities need to consider the impacts these asset owning entities may have in contributing to operating violations.

¹⁶ NERC Prepared Statement at P 13.

¹⁷ *See, e.g.*, Tr. at p137:17 – 138:18 (comments of Ed Schwerdt, Northeast Power Coordinating Council President).

In conclusion, this example illustrates either that the compliance registry is a non-exclusive tool when determining enforcement action, or that more work is needed to develop even more granular standards for use in ISO and RTO regions to ensure that those with key reliability responsibilities are held accountable through the requirements of every Standard, and, in so doing, improve reliability. In the interim, the remedy proposed by the ERO is simply insufficient to address the need for the penalty to be properly assessed against those entities whose actions or omissions require remedying.

III. CONCLUSION

In certifying NERC as the ERO in Order No. 672, the Commission recognized the unique characteristics of ISOs and RTOs should be taken into account when considering the possible application of a monetary penalty to those entities. The Commission must ensure that NERC and the Regional Entities adhere to this guidance when assessing the imposition of penalties on ISOs and RTOs. In approving the Reliability Standards in Order No. 693, the Commission also recognized that the Reliability Standards require improvement and may not always synchronize in sufficient granularity or detail so that the actions or omissions of certain entities (whether they are registered entities or not) may contribute to, or “cause”, the other entities to be “non-compliant” or an adverse reliability impact. The Commission must ensure that NERC and the Regional Entities examine the root cause of violations and not simply impose a penalty on the entity registered for the function (even though that entity may not have caused or contributed to the violation).

The technical conference was notable for the degree to which the majority of participants agreed that: (a) non-monetary penalties are effective tools to manage against and correct non-compliant activities for ISOs and RTOs, and (b) the degree to which participants (whether registered or not) that *own assets* can impact the performance of entities that *only operate* the

assets, and therefore rely on asset owners to respond to operating instructions and report on the characteristics and capabilities of their facilities in a timely and accurate manner. The Commission should take into account the input received from this cross section of industry participants before issuing a final ruling in this proceeding. Moreover, while addressing the issues concerning the ERO penalty assessment analysis, it should allow individual RTOs/ISOs, if they deem it necessary, to file changes to tariff or governing document provisions to address the unique circumstances and/or lack of clarity which may exist for individual RTOs/ISOs concerning financial penalties in light of each RTO/ISO's individual set of tariffs or governing documents.

Respectfully submitted,

/s/ Craig Glazer

Craig Glazer
Vice President – Federal Government
Policy
Steven R. Pincus – Senior Counsel
Regulatory
PJM Interconnection, L.L.C.
1200 G Street, NW, Suite 600
Washington, DC 20005

/s/ Stephen G. Kozey

Stephen G. Kozey
Vice President and General Counsel
**Midwest Independent Transmission
System Operator, Inc.**
701 City Center Drive
Carmel, IN 46032

/s/ Theodore J. Paradise

Theodore J. Paradise
Senior Regulatory Counsel
ISO New England Inc.
One Sullivan Road
Holyoke, MA 01040

/s/ Anthony J. Ivancovich

Nancy Saracino
Vice President, General Counsel &
Corporate Secretary
Anthony J. Ivancovich
Assistant General Counsel
**California Independent System
Operator Corporation**
151 Blue Ravine Road
Folsom, CA 95630

/s/ Kim Warren

Kim Warren
Manager, Regulatory Affairs
**Independent Electricity System
Operator of Ontario**
655 Bay Street, Suite 410
Toronto, Ontario M5G-2K4

/s/ Diana Pommen

Diana Pommen
Director Interjurisdictional Affairs
**Independent System Operator operating
as the Alberta Electric System Operator**
Calgary Place
2500 330 - 5th Avenue SW
Calgary, AB T2P 0L4

/s/ Michael G. Grable

Michael G. Grable
Assistant General Counsel
Electric Reliability Council of Texas
7620 Metro Center Drive
Austin, TX 78744

Robert E. Fernandez

Robert E. Fernandez
Vice President and General Counsel
Elaine D. Robinson
Director of Regulatory Affairs
**New York Independent System
Operator, Inc.**
10 Krey Blvd
Rensselaer, NY 12144

/s/ Stacy Duckett

Stacy Duckett
General Counsel & Corporate Secretary
Southwest Power Pool
415 North McKinley
#140, Plaza West
Little Rock, AR 72205-3020

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