

UNITED STATES OF AMERICA
Before the
FEDERAL ENERGY REGULATORY COMMISSION

Reliability Standard Compliance and Enforcement in Regions with Independent System Operators and Regional Transmission Organizations

Docket No. AD07-12-000

I am John Anderson, President and CEO of the Electricity Consumers Resource Council (ELCON). ELCON is the national association of large industrial users of electricity from virtually every manufacturing sector. A reliable electricity grid is essential to ELCON members. For that reason, ELCON was active in drafting the reliability language that eventually became part of the Energy Policy Act of 2005. And ELCON staff and members serve on many committees and devote a lot of time and effort in the North American Electric Reliability Corporation (NERC).

ELCON appreciates the invitation to appear before the Commission to share our views on issues associated with cost recovery of penalties for Reliability Standard Violations assessed against Independent System Operators and Regional Transmission Organizations, as set forth in Midwest Independent Transmission System Operator, Inc. 119 FERC ¶ 61,222 (May 31, 2007) in Docket Nos. ER07-701-000 and AD07-12-00.

I will first outline ELCON's understanding of how the process of assessing penalties for noncompliance with reliability standards is supposed to work, then briefly explain why we believe that the process outlined by MISO in its filing is inappropriate, generally state that no penalties assessed to ISOs and RTOs should be passed through to either the ISO or RTO members or to consumers, discuss how both monetary and non-monetary penalties should be applied to ISOs and RTOs, and conclude with an assertion that the problem before the commission today is just the proverbial "tip of the iceberg" with much larger problems to come.

I. ELCON's UNDERSTANDING OF HOW THE PROCESS OF ASSESSING PENALTIES FOR NONCOMPLIANCE WITH RELIABILITY STANDARDS IS SUPPOSED TO WORK:

The Energy Policy Act of 2005 authorized FERC to approve an Electric Reliability Organization (ERO). FERC certified the NERC as the ERO. NERC and the individual regional entities (REs) have the responsibility to see that all entities that can have a material impact on bulk power reliability are registered in NERC's Compliance Registry. [For brevity, herein I will use the term "NERC" in place of "NERC and the REs."] Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs) rightfully are included in the Registry for many reasons (e.g., RCs, BAs, TOPs, PAs, TSPs, etc.).¹ NERC establishes, subject to FERC approval, mandatory reliability standards that may involve penalties, sanctions, and remedial actions including monetary and non-monetary penalties assessed to those responsible for noncompliance. The process used by NERC is ANSI approved and is fair, open, and inclusive. Any party can participate in the development of the standards including any ISO/RTO. Any entity has the right to appeal either a placement in the Registry or a finding of noncompliance, first to the region, then to NERC, and finally to FERC. NERC can find an ISO or RTO responsible for noncompliance, and an ISO or RTO can appeal any NERC finding of noncompliance

II. ELCON's UNDERSTANDING OF THE MISO PROPOSAL:

MISO proposes to add Schedule 10-ERO to address any penalties assessed by NERC. MISO would directly assign the penalty costs to specific Tariff Customers if MISO determines that the violation is due to their non-compliance, following an FPA section 205 filing and FERC approval. If MISO is unable to identify the specific Tariff Customer(s) responsibility for the violation, the penalty costs will be allocated under proposed Schedule 10-ERO to all Tariff Customers based on the level of their energy injections and withdrawals from the MISO transmission system. This proposal thus

¹ Reliability Coordinators (RCs), Balancing Authorities (Bas), Transmission Operators (TOPs), Planning Authorities (Pas), and Transmission Service Providers (TSPs).

holds MISO harmless for any violations of NERC standards. Thus, ELCON believes this proposal is inappropriate.

III. NO PENALTIES ASSESSED TO ISOs OR RTOs SHOULD BE PASSED THROUGH TO EITHER THE ISO OR RTO MEMBERS OR TO CONSUMERS:

ELCON believes that **NO** penalties assessed to ISOs/RTOs should be passed through to either the ISO/RTO members or to consumers. As long as NERC does its job correctly, NERC will assess penalties to any MISO members or Tariff Customer(s) directly – not through MISO. Again, as long as NERC does its job correctly, any NERC penalty assessment to MISO (or to any ISO/RTO) is because NERC has determined that MISO itself is the entity in noncompliance. MISO can, of course, appeal any NERC decision. However, MISO should not have the authority to independently reconsider on its own any NERC decision. If MISO is the guilty party, MISO Tariff Customer(s) (or consumers) should not have to pay the penalties.

IV. BOTH MONETARY AND NON-MONETARY PENALTIES SHOULD BE CONSIDERED FOR ISO/RTO NONCOMPLIANCE:

At the outset I emphasize that I am not an expert on penalties. However, I do represent very large electricity consumers who are dependent on a reliable grid. These consumers feel very strongly that any entity responsible for bulk power reliability problems should pay the penalties if they fail to comply. This principle should apply to ISOs and RTOs as well as to all other owners and operators of the bulk power system. This situation is not unique to the electric industry. It is my understanding that many agencies focus civil enforcement efforts including both monetary and non-monetary penalties against both the regulated corporate entity and culpable officers and employees of those entities.²

ISOs and RTOs are non-profit organizations that will make every effort to pass through all costs to their market participant members. Moreover, ISOs and RTOs are

² Examples include SEC, CFTC, FDIC, EPA, OSHA, MSHA and NRC.

unusual in that not only are they non-profit, but unlike many other non-profit entities they have very few assets and have a captive revenue base. These characteristics of ISOs and RTOs make it very difficult to hold the ISOs and RTOs accountable because monetary penalties that are passed through do not have a punitive or deterrent effect on ISOs/RTOs and instead unfairly punish the captive dues payers who have no culpability. If those penalties are passed on to end users, the end users, rather than the culpable parties, become the victims of the violation.

Due to these characteristics, ELCON believes that non-monetary penalties may be appropriate in many, if not most, cases. FERC recognized in Order 672 that “the entity’s unique characteristics” may be considered “in determining an appropriate and effective sanction” (¶¶ 634-635) and in Order 672-A that, in addition “circumstances such as organizational structure or not-for-profit status will be considered” and that “penalties may be . . . non-monetary.” (¶¶ 56-57). FERC further recognized that its enforcement authorities apply to individuals as well to corporate entities and that it has broad flexibility to determine whether penalties are appropriate in addition to other sanctions.³

Other agencies have applied non-monetary penalties. For example, Department of Justice guidelines on enforcement actions against corporations provide that consideration is to be given to “collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution.”⁴ The same principles could apply in actions against ISOs/RTOs. As another example, the National Institutes of Health imposes various sanctions such as imposing conditions on future actions, closer monitoring, and sharing information about the sanctions with other interested entities.⁵

NERC’s own Sanction Guidelines currently recognize that “[t]he imposition of sanctions is not bounded to monetary penalties” and note that they may include “[l]imitations on activities, functions or operations” and “[p]lacing an entity on a

³ See Policy Statement on Enforcement, 113 FERC ¶ 61,068 (Oct. 20, 2005) at ¶¶ 11-15.

⁴ See Department of Justice, “Principles of Federal Prosecution of Business Organizations (Dec. 2006).

⁵ See NIH Grants Policy Statement, Oct. 2003.

reliability watch list composed of major violators.”⁶ These Guidelines identify a variety of remedial actions that also could be added to the list of sanctions for violations: “(a) specifying operating or planning criteria, limits, or limitations; (b) requiring specific system studies; (c) defining operating practices or guidelines; (d) requiring confirmation or data, practices, or procedures through inspection testing or other methods; (e) requiring specific training for personnel; and (f) requiring development of specific operating plans.”⁷ ELCON supports this approach and believes that the list of available non-monetary sanctions should be expanded.

However, our call for an emphasis on non-monetary penalties does not mean that monetary penalties should never be assessed in these instances. Should NERC determine that monetary penalties should be imposed on an ISO or RTO, they should be sought only from the individual officer(s) or employee(s) clearly culpable of the alleged violation of the reliability standards, and not from the ISO/RTO entity. FERC’s Policy Statement on Enforcement recognizes that FERC has the statutory authority to pursue enforcement actions against individuals as well as corporations. Since NERC’s authority ultimately derives from the Federal Power Act enforcement provisions, NERC should have similar delegated authority. Such an approach would prevent the penalty amount from being simply passed through as a cost to the non-culpable members. That may mean, for example, that salaries and/or bonuses of ISO/RTO employees are reduced to pay the penalties. Singling out individuals as culpable is not unique. As an example, the NRC has issued a specific list of circumstances where enforcement actions against individuals are appropriate.⁸ Although the context is somewhat different, it could instruct development of a similar list for officers and employees of ISOs/RTOs.

Such a step should not be taken lightly. Culpability should be clear. But to exclude the possibility of monetary penalties against individuals would insulate guilty parties from an appropriate punishment. Those individuals who have violated reliability

⁶ See NERC Sanction Guidelines Sec. 5.

⁷ See NERC Sanction Guidelines Sec. 6.7.

⁸ See NRC Enforcement Policy, Sec. VIII.

standards – and in so doing have put a portion of the grid at risk – must also pay an appropriate penalty.

In sum, ELCON believes that any enforcement action against ISOs/RTOs for alleged violation of NERC reliability standards may include both monetary and non-monetary penalties. Monetary penalties should be sought only from the individual officer(s) or employee(s) clearly culpable of the alleged violation. Non-monetary penalties can take many forms including: publicity about violations of reliability standards; increased auditing of and reporting by the entity; mandatory training; decertification of certain individuals; to the ultimate sanction (only appropriate in extraordinary circumstances and where a new entity is ready to step in) of decertification of the ISO/RTO (to mention only a few examples).

V. ELCON EMPHASIZES THAT THE PROBLEM BEFORE FERC TODAY IS MUCH LARGER THAN THE PASS-THROUGHS OF NERC COMPLIANCE PENALTIES:

The problem before us today is how can we hold non-profit ISOs/RTOs accountable for their actions (or inactions) regarding NERC standards. The bigger problem is how do we hold nonprofit ISOs/RTOs accountable for **ALL** of their actions. ELCON has documented numerous problems with the “markets” in today’s ISOs and RTOs. Given the difficulty in holding non-profit ISOs and RTOs accountable for violations of NERC’s reliability standards, it is no wonder that little real action has been taken by the ISOs and RTOs to fix the much larger problems with the markets.