BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

IN THE MATTER OF:
RELIABILITY STANDARD COMPLIANCE AND ENFORCEMENT IN REGIONS WITH INDEPENDENT SYSTEM OPERATORS AND REGIONAL TRANSMISSION ORGANIZATIONS:

Hearing Room 2C
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC

Tuesday, September 18, 2007

The above-entitled matter came on for conference, pursuant to notice, at 9:30 a.m.

BEFORE:
Donald LeKang, Presiding
PROCEEDINGS

MR. LE KANG: Shall we take our seats, please.

(Pause.)

MR. LE KANG: Good morning. Thank you for coming. Today the Commission Staff is holding this technical conference to explore issues associated with cost recovery of penalties for reliability standard violation assessed against independent system operators and regional transmission organizations.

There will be three panels presenting today. Each is expected to last approximately one hour. The first panel will consist of RTOs and ISOs. The second panel will consist of representative entities potentially subject to paying penalties incurred by the RTOs or ISOs. The third panel will consist of the North American Electric Reliability Corporation and regional entities.

Before the first panel starts I'd like to just mention a few housekeeping items. First, please make sure your cell phones are silenced and any pagers silenced. We're hoping that this conference will be somewhat informal and provide enough discussion for Staff to completely understand the issues. So feel free to go in and out if necessary.

Restrooms are located in the hallways behind the elevators on both ends of the building.
We've asked each of the panelists to limit their remarks to approximately five minutes in time to allow Staff enough time to ask questions. We will not be taking questions from the audience; it's strictly Staff questions and answers.

Finally, comments may be filed in this docket, AD07-12, over the next few weeks. That's through October 2nd. Following that the Commission will determine what appropriate steps to take next.

Let's get started with the first panel. We'll begin with remarks on my left with Mr. Lynch and move down the table.

Please introduce yourself prior to your statements. Thank you.

MR. LYNCH: Good morning. I'm Mark Lynch, Chief Executive Officer of the New York ISO. I'd like to thank you for this opportunity to speak to you directly on the important issue of cost recovery of penalties for reliability standard violations assessed against ISOs and RTOs.

I've submitted more comprehensive written comments, and we have the comments in the back as well as posted on our website.

This morning I'll focus on two areas: First, the processes the NYISO has institutionalized to ensure
compliance in this area and throughout our operation, and, secondly, what alternative sanctions the Commission can impose that would be as or perhaps more effective than monetary penalties in changing the behavior of a not-for-profit organization.

The second statement is based on the fact that no one on the NYISO Board of Directors or employed in any capacity at the NYISO is permitted to have any financial interest in the NYISO's operations or our markets.

A not-for-profit's assets have a reputation for competence and integrity. Penalties that could reduce that are at least equivalent to financial penalties, and its reputation could be harder to rebuild than a balance sheet. But the NYISO and members of its predecessor, the New York Power Pool, have a successful record of compliance with mandatory reliability rules in New York State and are strong advocates for making the NERC standards mandatory and enforceable.

The NYISO's commitment to compliance extends to all regulated areas of its operation and is based on continuous improvements starting with process mapping, the institution and testing of controls and training, followed by rigorous self-assessment.

All NYISO employees must take initial training and annual recertification that includes the importance of
all aspects of compliance. There is more extensive annual recertification training for officers and managers.

The NYISO's current reliability compliance process enhances the documentation of compliance and ensures that future changes to NYISO's policies and procedures do not put the NYISO at risk for violation of existing rules. Further, the NYISO's compliance process facilitates efficient implementation of changes to rules and supports the NYISO's preparation for future audits.

The NYISO is mapping each of the approximately 1817 separate ERA requirements and establishing a schedule to complete collecting required documentation. With these processes in place we feel the NYISO is well positioned to successfully manage the new mandatory reliability compliance regime.

I will now return to the subject of financial penalties and why they are not the most effective way to influencing the performance of a not-for-profit ISO or RTO.

Unlike other segments of the industry which are now subject to the mandatory reliability standards, the NYISO has no incentive to gain or evade reliability rules and has no affiliated companies that would benefit financially from such strategies. Nor does the NYISO have financial assets that would be diminished by monetary penalties.
The NYSO is a not-for-profit corporation that relies on an annual operating budget developed with the market participants and approved by an independent board. The NYISO budget does not contain a single dollar for payment of penalties. Accordingly, imposing financial penalties on the NYISO could in the worst case render it insolvent and unable to operate the bulk power system and administer the wholesale competitive markets, the very purpose that it was approved by FERC to perform.

To avoid even the possibility of insolvency the Commission could allow recovery of monetary penalties from NYISO's customers. But such as pass-through would only impose additional costs on NYISO's customers, some or all of which may have played no role in the violation.

I am not suggesting that FERC take on blind faith that management will unerringly address reliability problems, though I believe this to be true.

There is, however, sufficient reason for the Commission to believe that ISOs, RTOs and the NYISO in particular will behave appropriately even in the absence of the threat of a fine. The NYISO staff has decades of experience maintaining the reliability of the New York power grid. The NYISO fully supported the new reliability standards and we pride ourselves on our compliance with reliability requirements, both before and after the new
reliability standards were implemented.

Indeed, compliance with reliability standards was mandatory for the NYISO long before Congress enacted the Energy Policy Act of 2005.

The Commission has a spectrum of non-financial enforcement mechanisms it could use, including instituting formal investigation and/or formal audits; issuing remedial orders or consent orders that directly necessitate improvements; requiring follow-up status reports to monitor ISO/RTO progress; stationing FERC Staff in ISO/RTO offices; issuing public reprimands or placing an offending entity on a watch list or requiring independent technical oversight by a committee of experts. I can see that any one of these non-monetary penalties if imposed on the NYISO would have a significant impact on the NYISO management and our board.

The Commission can rest assured that non-monetary penalties will provide adequate incentive to comply with reliability standards.

The NYISO board, management, and its stakeholders take system reliability very seriously. And any instance of non-compliance would be corrected immediately and completely from the internal management perspective. We have only one incentive: That is to do it right.

In conclusion, non-monetary penalties are the appropriate measure to be assessed against a not-for-profit
ISO/RTO like the NYISO that has neither the financial assets nor the incentives. Non-monetary sanctions and compliance programs will provide appropriate incentives for ISOs and RTOs to ensure compliance.

But if the Commission does choose to assess monetary penalties against a not-for-profit ISO or RTO in order for the organization to continue to provide its essential services the Commission should adopt a policy that ensures rate recovery of such penalties, either from the entities who are at fault and/or if that entity is the NYISO, through a general charge to all customers.

That concludes my comments. And I look forward to your questions at the end of the panel.

MR. LE KANG: Thank you, Mark.

Steve.

MR. PINCUS: Thank you.

My name is Steve Pincus, senior counsel with PJM Interconnection. I'm going to address two main topics that arise out of the Midwest ISO order and the proceeding there, as well as subjects that were under discussion among PJM's members and PJM.

The first topic is the question of whether and how RTOs should directly assign reliability standard penalty costs to individual members whose conduct caused the violation to occur. But because PJM would be the registered
entity, PJM would be responsible for paying the penalty. And the penalty would be assessed against PJM as that responsible entity.

The question is whether the direct assignment should be allowed. Yes.

In fact, PJM's members expressed concern with the possibility that PJM, therefore indirectly all of its members, would be held financially responsible for penalty costs that arise from the conduct of an individual or group of members. In doing so, however, it's important that the process include a root cause analysis and make findings to identify contributors and facts leading to the violation.

In this process it would also be important to have notice and an opportunity to be heard so individual members will ultimately be financially responsible for the penalty and can participate in the process and assist in making the root cause findings. This process should be kept separate and distinct from another aspect, another step in the overall process. That would be having the ERO make its findings and root cause analysis.

The RTO, its members, and ultimately the Commission would make a determination of whether or not the conduct of the members was a violation of RTO's tariff, operating agreement, or other contractual agreement between the RTO and the members.
As I said, if there are disputes that question should go to the Commission. I want to point out that this would not violate the Commission's concerns in the Midwest ISO order of duplicative proceedings and bypassing the ERO or the compliance enforcement process. The ERO findings would be binding on the RTO and all parties involved in the second step.

The issues under consideration in the compliance enforcement process would not be revisited in the second step, and nor would the allocation -- that is, the issuance of penalty. The second step would be more in the nature of a cost allocation among the members or to the members of the RTO.

The second issue I want to address -- and the point I need to address -- is whether RTOs have adequate incentives to comply with NERC standards if the penalty costs are passed through to its members. In PJM the answer is definitively yes.

PJM operates under a stated rate construct. The stated rate prevents PJM from simply passing through these penalties directly to its members. The penalty would have to be paid through the stated rate fund, which is a formula cap on PJM's rates and the cost of the penalties would have to be absorbed through that rate structure.

The rate funds day to day operations of the RTO
so there would be definitively an incentive to avoid
depleting those funds by violating penalties and having to
pay out the costs of the NERC standard violation.

I want to point out that of course we're assuming
here that in this situation, in this scenario, that it's the
RTO that caused the underlying violation. Also, there are
additional incentives for RTOs and PJM specifically.

In the case of discretionary compensation NERC
standard compliance has always been an element of PJM's
metrics that goes into the determination of discretionary
compensation.

Another aspect would be member satisfaction
goals, which are also a key element of PJM's compensation
metric. Certainly if violations occur and penalties have to
be paid member satisfaction will drop and this will directly
impact the compensation metrics. Therefore the employees at
all levels of the company, senior management and throughout
the entire company would be financially impacted by
reliability standard violations. So the incentive is
certainly there to comply with the standards.

The construct I just outlined to you I believe
allows for an equitable direct assignment of penalty costs
to individual RTO members in a way that addresses the
Commission's concerns expressed in the May 31st order. That
is, bypassing -- or that is, avoiding bypassing the ERO
compliance process, avoiding duplicative proceedings and holding the right parties financially accountable for the violations and penalties.

That concludes my presentation. I look forward to your questions.

MR. LE KANG: Thank you, Steve.

Mike.

MR. GRABLE: Good morning. Thanks, Don.

My name is Mike Grable, Assistant General counsel at the Electric Reliability Council of Texas for Regulatory and Legislative Affairs. I appreciate the opportunity to visit with the Commission Staff this morning.

Don and Keith, as you already know, my comments are more directed to ERCOT's interest in being responsive to the Commission's interest in this issue rather than stating an affirmative position on many of the issues before us. But there are a few comments I'd like to make.

As you perhaps know, we are somewhat unique among ISOs and RTOs in that we are originally a creature of the Texas legislature and not of the Commission. However, we fully respect and understand the Commission's authority over reliability standards and the importance of participating in this process.

One of the things that occurred to me as I looked over the list of questions to be addressed today is that the
same topic kept occurring to me as I looked at them. That is that because we developed our market structure in a somewhat unique way under Texas law we have protocols that do not map very well to the federal reliability standards. The first thing that we need to do is make sure that we have the correct entities registered with the Texas Regional Entity and NERC for each of the reliability standards and requirements and tasks. That is a process that has been begun in dialogue with our market participants and will be ongoing for some time. We are hopeful that many of the issues surrounding allocation can be solved if the correct entity is registered for the correct function, in general I will say thereby creating the no-gap and no-overlap approach that the Commission has expressed a desire to see.

In general we support the position of our fellow ISOs and RTOs on the benefits and advisability of non-monetary penalties. And I think I'll leave my comments at that.

Thank you very much.

MR. LE KANG:  Thank you, Mike.

Anthony.

MR. IVANCOVICH:  Good morning. My name is Anthony Ivancovich, Assistant General Counsel for Regulatory for the California Independent System Operator Corporation.
I appreciate the opportunity to speak this morning on these important issues.

As we see it, this technical conference addresses two very important issues. First, if an ISO or RTO is responsible for violating a reliability standard what type of penalty should be imposed on the ISO or RTO; and if a monetary penalty is imposed, should be ISO or RTO be permitted to pass through such monetary penalty.

The second question we see as being addressed is what is the appropriate process to address the situation where an ISO or RTO may be assessed a penalty but the violation is caused by a third-party.

With respect to the first issue, we believe that monetary penalties are not the most appropriate method for penalizing non-profit ISOs and RTOs for reliability standards violations. As you are well aware, over the long time ISOs and RTOs have virtually no ability to pay financial sanctions absent some pass-through mechanism because we have no resources of our own.

However, we do not believe that monetary penalties are necessary to incent compliance with reliability standards. Non-monetary penalties and incentive compensation mechanisms such as those that the CAISO has are more than sufficient to get ISOs and RTOs to comply with reliability standards.
The California ISO's board of governors has approved a comprehensive five-year plan that sets forth our strategic objectives, corporate objectives and corporate priorities. One of our five-year plan strategic initiatives is to achieve excellence in grid and market operations. A key deliverable in achieving that goal is complying with the reliability standards. To that end our 2007 corporate goals and prior year's goals have as a specific goal meeting the reliability standards.

Each and every Cal ISO employee owns this goal because each and every Cal ISO employee's incentive compensation is affected by our compliance or non-compliance with the reliability standards. We believe that this performance-based approach provides for direct accountability and constitutes an effective incentive for the ISO to comply with reliability standards.

Because our approach gets leaders and resources committed to complying with these standards and penalizes the persons who are directly responsible for compliance, we believe that this constitutes an effective substitute for shareholders bearing penalties.

In addition to incentive compensation measures, we believe that non-monetary penalties, such as publication of violations, can be an extremely effective and transparent means of incenting compliance.
To the extent monetary penalties are imposed on ISOs and RTOs, we believe that the Commission should allow them to be passed through to all customers. As I indicated above, absent a pass-through mechanism ISOs and RTOs have limited ability to pay these financial sanctions.

We recognize that the Commission has a concern as to whether or not ISOs and RTOs have sufficient incentive to comply with the reliability standards. The Cal ISO has tremendous incentive to comply because every one of our employees' compensation is docked for non-compliance.

Also, precedent exists for passing through monetary penalties for violations of reliability standards. In that regarding the Cal ISO's existing tariff permits the ISO to pass through WECC penalties for reliability standards violations.

As a final note on this subject, we believe it is fair to spread penalty costs as broadly as possible to all customers so as not to unduly burden any particular class of customer. That is especially appropriate given that the customers would not have been the entities that caused the non-compliance.

With respect to the second issue, we believe that a fair and efficient process must be in place to ensure that penalties are imposed on the entity that causes the reliability standard violation. Absent some sort of tariff
or contract mechanism the potential exists for an ISO to be penalized even though the fault lies with a third party.

To address that issue the ISO has entered into a reliability standards agreement with its PTOs who are also registered with the Cal ISO as transmission operators. That RSA specifies the requirements associated with each and every reliability standard with which we must comply and identifies the specific entities responsible for compliance with each element.

If two entities are responsible for a specific requirement the RSA specifies a primary party and a supporting party and sets forth the responsibilities of each. Under the ISO if we are the responsible entity we will receive the notice of violation for WECC and from that point we will work with the TOPs to determine who the responsible party is.

To the extent the responsible party is the ISO we would seek to pass those dollars through a tariff mechanism. To the extent the responsible party is a PTO the penalty should be assigned to them.

I think the real problem here is that under the RSA if there is a dispute it would go to arbitration. We believe that a better approach would be for WECC and other regional entities to determine who the culpable party is rather than have multiple proceedings dealing with the same
issue of non-compliance.

As a final note, we believe that our reliability services agreement can be used for other reliability standards where our compliance is dependent on the performance of tasks by other members of the ISO or RTO.

This concludes my comments. I look forward to any questions you might have.

MR. LE KANG: Thank you, Anthony.

Les.

MR. DILLAHUNTY: Thank you. I am Les Dillahunty of the Southwest Power Pool. I, too, appreciate the opportunity to be on this panel to address this important subject.

SPP has been a regional reliability council of the North American Electric Reliability Council for many years before becoming an RTO in 2004. As a FERC-approved RTO you have already assessed our independence in terms of actions and processes, as well as made a determination that we're not significantly affected by any economic or commercial interest in our decisionmaking processes.

SPP continues to express the opinion that monetary penalties for non-profit RTOs and ISOs are not needed. The hallmark of SPP's corporate culture is our dedication to system reliability. Should after due process a penalty be confirmed involving the Southwest Power Pool we
would take to our stakeholders and board of directors not only the causation of the penalty but our recommendation for addressing that penalty -- hopefully it would have already been addressed at that time -- and any penalty, monetary or non-monetary, before the Board.

We would also be willing to post the violation on our website. We believe strongly in our stakeholder process that has served us for many years, and we also believe in our internal management ability to address reliability needs as we have done for many years without the necessity for these monetary penalties.

We believe that monetary penalties for non-profits are problematic at best. We have no ready source to pay these penalties and we would need to collect them from our customers or our members. Borrowing funds to pay these operating or finance costs could cause us to have a lower credit rating or an increased cost of capital. Such penalties as these were not anticipated when our governing documents were formulated.

So we would propose that if there are monetary penalties that they be taken to our board of directors and they would direct the RTO to make a Section 205 application for recovery of these penalties from our customers. Failing that we would rely upon the general provisions of our membership agreement that would subject our 50 members to
these penalty costs.

SPP has no mechanism for directly assigning the causation of any of these penalties. And we do not want that responsibility. We believe that the due process procedure is to determine that. And in fact the RE, ERO and this Commission are the ones who are directly assigned the responsibility for determining the cause of any violation.

We believe that an assignment of any of these responsibilities to the RTO would be a duplication of efforts. Should this Commission ultimately determine that monetary penalties for non-profit RTOs and ISOs such as SPP -- particularly in our case we would like to continue to come to you for a Section 205 application seeking to recover the cost of the penalties from our customers.

We also believe that if these penalties become significant enough that our stakeholders and board of directors will respond by instituting reforms.

Thank you very much for the opportunity to comment.

MR. LE KANG: Thank you, Les.

Stephen.

MR. KOZET: Good morning.

Everybody else said thank you. I guess I owe you a special thank you. My filing back earlier in the year got a different kind of attention than I imagined it would. And
I did not necessarily envision this much of the Commission's resources addressing this. So thank you, indeed.

My formal comments that will get filed a little bit later today will sound a lot like what you heard from all the other entities here. So I thought I'd just talk to you about a few things in the comments that are a little bit different. But just because I'm going to dig in to assuming penalties, please don't overlook: We do share in common with each of the other ISOs things you've heard about a culture trying to assure that there never be a violation.

We have a vice president of the company in charge of compliance. We've been participating in the NERC and regional teams to set standards so that we understand what they are. The responsibilities that have been given to us are mapped down to our operational real time folks on a daily basis. We've gotten through NERC audit recognition for examples of excellence in dealing with reliability.

So while I'm talking here today about the pessimistic hypothetical of a reliability violation being found, please don't overlook the fact that, like the other organizations, we all are dedicated to trying to ensure that that never be the case.

You heard the non-profit argument from each of us. People have been very polite. The worst possible outcome for a non-profit in a circumstance where cost pass-
through or recovery was denied eventually would be insolvency and reorganization. Although I hope a tail end event and very, very low risk, that would be a bad -- I urge upon you -- policy outcome for the Commission. Hence, you've heard a lot of people beforehand talk about why non-monetary penalties might be appropriate for ISOs and RTOs. I agree.

Mr. Dillahunty talked about core agreements. And you had questions about, well, should this be better handled in a mantle of contractor tariff. RTO tariffs and operational agreements generally -- and ours in particular -- predate Section 215 of the Federal Power Act. They don't consistently address this subject.

In the Midwest ISO we have three documents on file with you here at the Commission which deal with indemnification and penalties. They're found in our tariff itself, in the transmission owners' agreement, and in the balancing authorities' agreement.

We also have joint operating agreements with PJM, SPP, and there are mentions of joint indemnification in those. These provisions don't provide a consistent basis for dealing with ERO penalties because they do not directly address them as a topic, or they have a limited scope in terms of both the actions and entities that re covered. Or they're subject to burdensome dispute resolution
requirements. Or they may exclude negligent or grossly negligent or intentional actions from their coverage.

Hence the need to have a tariff provision much like the one that's on file in the California ISO tariff before you.

A lot of commenters expressed a concern that permitting entities like ours to automatically pass-through penalties would diminish the organizations' accountability. We disagree.

My comments do repeat the lack of for-profit motivation. But certainly in a for-profit company threatening their profit for a violation of reliability standards is a key step. Not having that doesn't mean that we're not accountable.

We also have compensation elements that affect all employees, not just the officers. But I know from experience in our company that since all the officers are appointed by the Midwest ISO board of directors and serve at its pleasure the board could certainly dismiss one or more of us should there ever be such a violation.

The board in turn is accountable to its Midwest ISO members, which may remove any individual director by a majority vote, or elect not to return board members at the conclusion of their terms. Thus, any failure by the Midwest ISO management to ensure the highest standards of operation
can be dealt with through these governance channels.

The Commission's new powers under Section 215 of the Federal Power Act are extensive and encompass, among other things, the authority to impose non-monetary penalties that may include but are not limited to -- here in the words of the statute:

"--a limitation on activity, function, operation, or other appropriate sanction."

The Midwest ISO believes these authorities are lodged in the Commission and give it a hands-on control that would be adequate to ensure the desired level of accountability for any RTO or ISO.

When we move on to direct assignment perhaps no other aspect of our earlier proposal evoked more objections than direct assignment did. It was intended to be a rarely-used feature which was designed chiefly to provide additional safeguards rather than take due process rights away from anyone, as alleged by some commenters. Similar direct assignment proposals exist elsewhere, like in the Cal ISO.

Given the intensity of the opposition to the suggestion the Midwest ISO would like to stress it never has intended to use direct assignment to second-guess the ERO and the Commission or duplicate their work in the exercise of their statutory authority under Section 215 of the FPA.
These are direct but sort of humble acknowledgements. The Midwest ISO is not the ERO and certainly doesn't seek to exercise the ERO's powers and prerogatives. In fact, Midwest ISO greatly prefers that the ERO have the capability to ascertain violations on a sub-entity basis and collect penalties directly from those who caused or committed those violations. In such circumstances there would be no need for direct assignment as the ERO penalty proceeding would exhaust the matter instead.

The Midwest ISO's direct assignment option was proposed to address the hypothetical but nevertheless possible scenario in which the ERO only sees an ISO violation but the Midwest ISO has evidence that the violation was caused by actions of a specific entity. Under Section 215 the ERO's penalty authority is triggered only by the violation of a FERC-approved reliability standard.

It's not inconceivable that the Midwest ISO could technically violate a standard because of an action of another, which by itself may not necessarily be deemed a reliability standard violation. So our hope here was that while we would expect to vigorously participate in any ERO proceeding proposing to impose a penalty on the Midwest ISO and would provide all the information we had regarding potential culpability of other entities, the ERO may not necessarily be in a position to impose a penalty on such
entities because of legal or operational limitations.

In those circumstances the direct assignment option is a useful tool to put market participants on notice that they cannot hide behind an RTO if they cause it to violate a standard.

Where direct assignment is proposed a proceeding under Section 205 of the Federal Power Act would provide the necessary protection to all affected entities. The Midwest ISO cannot unilaterally assign the cost of the penalty to any particular entity but would merely propose that the commission to do upon review and investigation. That entity in question as well as all others would have full opportunity to oppose the Midwest ISO's proposal and, in the event the initial pleadings revealed an issue of fact, the Commission could refer the matter, as it usually does, to an ALJ for hearings.

If the Commission's review or hearing revealed that the Midwest ISO's concerns are without foundation the application for direct assignment would be rejected. If in other circumstances it's the Midwest ISO directly that's responsible and that we don't try to say anybody else was responsible, or in the event this 205 application were denied, we believe the cost of the penalty should be allocated pro rata across all market participants that engaged in market activities during the period of time the
event associated with the penalty occurred.

In our tariff language we propose that the penalty should be allocated in proportion to our Schedule 17 charges that were paid during that period of time. All the market participants benefit from the provision of a reliable market by the Midwest ISO and it's dependent upon the reliable operation of the physical assets that underlie the market. Therefore we think that these schedule 17 charges would be the appropriate basis for allocating penalties.

I've probably used up my five minutes. Thank you very much. I'm prepared to answer questions.

MR. LE KANG: Thank you, Stephen.

Let's see if Staff has any questions.

Keith.

MR. O'NEAL: A question for the whole group.

I know you're coming from a voluntary regime, which is quite different than the current mandatory regime. But do you have any experience in a voluntary regime? What does your experience say in terms of the number of penalties that you might have incurred in the voluntary regime versus -- and the amount of penalty you might have incurred in the voluntary regime? What's your experience been? Do you frequently get penalized? What's the nature of the penalty? Again, under the voluntary regime. We don't have any experience under the mandatory. But if you could just
kind of give an indication of what the history might be.

MR. LYNCH: I could go ahead and start.

We have actually at the New York ISO been under mandatory reliability rules since our inception with MPCC and the New York State Reliability Council. They put in place mandatory rules. They're in the form of non-monetary; essentially it's a notification and a publication of that notification to allow market participants and other entities to realize that there's been a violation.

Since '99 I think there's maybe only been once instance where we've ever received a letter; I think it was more of a minor type of event.

But overall, when you look at our compliance with the mandatory rules we've had in place all this time I think our performance has been, you know, I think a standard that others should actually follow. We've performed very well. Our operators have basically gone through extensive training.

We found that the non-monetary penalty of the type that has been in place before was very effective. And I think our operations actually stand as an example of that.

MR. PINCUS: In PJM we have always had the requirement to comply with NERC standards. As I mentioned in my initial presentation the employee compensation plans are -- the discretionary compensation have matrices that...
include the need to maintain reliability standards, NERC reliability standards.

I don't have specific statistics on how things have gone in the past. But I believe that PJM has an excellent record. And I think that the contract which we've had in place under the voluntary process has worked very well in PJM.

MR. GRABLE: Like New York ISO, ERCOT has also been subject to mandatory standards, albeit at a different regulatory level. The protocols that I mentioned previously, I'm personally aware of two informal allegations of ERCOT violating those protocols, but never a regulatory finding that we had done so.

MR. IVANCOVICH: California has been under a mandatory reliability standard through the WECC reliability management system. There are monetary penalties associated with that.

I can't speak off the top of my head what our compliance has been exactly, but it has been good. And in prior years we have always had reliability standards compliance reflected in our annual corporate goals. In the past they have pertained to these WECC standards on a going-forward basis. We anticipate it's going to be the NERC reliability standards.

MR. DILLAHUNTY: To my knowledge -- it's general
and not specific -- but during my four-year tenure at the Southwest Power Pool I am not aware of any violations that have occurred.

MR. KOZEY: This Agency participated in an international investigation into the causes of the August 14th, 2003 blackout. So, Keith, whether that meshes with the source of your question, I think you all know that we have invested substantial amounts of money since then, created tools, training, and added personnel, so that in our view the likelihood of any reliability related violation would be de minimis.

I thin your staff can also look to the NERC website where its reliability audits are posted and you'll find the NERC view of our readiness and performance there on the NERC website.

MR. LE KANG: I have a question for Stephen, and anyone else can chime in too.

You had mentioned the two different options for determining if there will be a direct assignment of a charge. MISO in this case would determine whether or not to look further.

Is there some trigger point that makes that determination of whether or not you look further? Or how is that figured?

MR. KOZEY: We would imagine that in that process
before the ERO or the regional entity where we provide the
information we have about market conditions or asset
behavior on the day or the period in question when the
violation took place, that information would be the basis of
any determination that another entity was involved.

If the ERO said we looked at that and that entity
is registered and not responsible, if the ERO or the
regional entity looked and said, 'well, we only need to look
as far as you, the Midwest ISO, because you are registered;
we are not going to inquire below,' that would be the
trigger -- the kind of event that would trigger us wanting
to put together a 205 filing and bring that to the
Commission so there would be no retrying of the matter.

MS. KUHLEN: Just as a follow-up to that answer,
if that situation where you identify somebody but it's not a
registered entity, at what point -- or do you envision that
you would bring that to the regional entity and suggest that
they incorporate that into their investigation so that the
matter can be handled at that level rather than waiting for
the due process proceeding of the regional entity and then
making a second either hearing of your own or a hearing
before FERC?

MR. KOZEY: I'm not sure I can answer well
because if this hypothetical comes about and we say here is
the facts that we have because of just data, the condition
on the grid, what happened, who did or didn't follow
instructions, whether something was given -- I thought I
heard your question to say if it turns out that we have a
view that somebody should have been a registered agent?

MS. KUHLEN: No.

If you have a view that somebody is at fault and
perhaps in the situation you mentioned where the regional
entity is just saying, 'Okay, MISO, you're the principal
registered entity and we're assessing blame to you,' and you
feel somebody else is involved, at what point would you make
that preliminary determination? And then if it's in time,
would you then go to the regional entity and say, 'I think
you should broaden the scope of your investigation'?

MR. KOZEY: We would imagine that it would be
coincident with the ERO or the regional entity
investigation.

MS. KUHLEN: So if they did that then there would
be no further need for you to take this to FERC.

MR. KOZEY: Yes.

MR. PINCUS: May I also address that?

As I described in our construct, we see the need
in order to directly assign to have ERO, the regional entity
in the first place make these request findings, identify the
underlying causes and the contributors to the violation, it
wouldn't be the RTO at all making those findings. What we
envision is a construct in which -- we do not have it in place, by the way, I want to make it clear we don't have an indemnity provision or a direct assignment provision in our tariff or operating agreements. It's something that needs to be developed and filed.

But what we're envisioning is to create such a construct and allow the entity to directly assign when there's a finding by the ERO of the individual entity or group of entities, members of PJM caused the violation to occur -- PJM being a registered entity would be assessed a penalty. Then based on those findings make a determination whether there was in fact a violation of the operating agreement or tariff or the underlying agreement.

I just want to make that clear: What we're proposing anyway is not a process that would require the RTO to make these kind of findings. It would require that these findings be determined by the ERO compliance enforcement process.

Thank you.

MR. LYNCH: If I may, I think I'd reinforce that. We'd be looking to the regional entity and the ERO to basically conduct the investigation.

Obviously in the first instance we'd provide all the necessary information, provide any data, or I guess materials that we would have that would be material or
substantive to the investigation. But we'd really look to
them to get to the due process, not only on our actions but
the actions of all the other registered entities or other
entities within our market place that potentially were the
root cause of the violation and make that determination and
have that due process go through. Then we'd use the results
of that for anything we needed to proceed with.

MR. MORIE: I have kind of a basic question.

MR. GRABLE: Roger, could I add one more thing to
that? I apologize.

I think part of your question has to do with
entity that at the time was not a registered entity. Part
of the question needs to go to NERC and the regional
entities, whether they would allow what is at the time a
non-registered entity to be brought into their investigation
and potentially included in any enforcement action.

MR. O'NEAL: Can I just follow up on that?

That's a good point.

Are any of you aware whether or not there would
be an unregistered entity within your ISO or RTO that has a
reliability responsibility?

MR. PINCUS: The responsibilities are with the
registered entity. In PJM we've registered for many of the
functions of the functional model. However, there are tasks
that need to be performed by our individual members that we
contractually and by tariff have performed by our members.

Those members are not registered entities. PJM remains the registered entity and therefore the responsible entity. But FERC has made clear that we will remain, as far as FERC and ERO goes, as the registered entity. The RTO will remain primarily responsible for payment of the penalty.

What we're trying to do is develop this construct so that nevertheless under our tariffs and operating agreement the ability after the findings are made and the entity whose -- the member who's failed to carry out that particular task has been identified would be the ability to pass through the costs of the penalty that is to be paid primarily by the RTO.

MR. O'NEAL: Just to follow up, if there are entities then that are not registered but provide some sort of task, as you use the word "task," I think you're all agreeing that the regional entities and/or the ERO will be doing the investigation. How can they investigate an entity that is not registered?

I think the process is that they'd be only investigating the situation relative to the registered entities. Are you suggesting that you go further?

MR. PINCUS: Yes. I believe they should drill down much further. They should not stop at the registered
entity. There should be a thorough investigation.

The Commission has recognized that there's a unique circumstance and unique construct in our ISOs and RTOs that need to be considered in evaluating these issues. And that is exactly the unique circumstance that needs to be considered and addressed through the compliance process.

MR. O'NEAL: And you don't see a legal issue or anything that would restrain that kind of investigation?

MR. PINCUS: I believe that the ERO can perform that kind of investigation.

MR. KOZEY: Keith, if the investigation is into facts and the ISO or RTO has a lot of factual information then I think it's different than, say a court having jurisdiction over a person or an entity. And the ERO or the regional entity can deal with the facts it's presented.

It may, as Steve Pincus, who was answering it, may only have the RTO or ISO to point to, if that's the only registered entity. But that shouldn't limit the information that it can inquire into.

MR. O'NEAL: Thank you.

MR. MORIE: I wanted to address a question to each of the panelists.

If your organization were ordered or required to pay a monetary penalty how would it get the funds to pay the penalty? And if it did pay the penalty would it incur any
additional costs as a result of doing so?

MR. LYNCH: I think that's the crux of the matter here.

I think our tariff and organic documents provide enough ambiguity that we're not sure that we could, if assessed a penalty, be able to pass that through or work it through our mechanisms. Obviously we would exhaust all of the avenues to basically meet the intent to pay the penalty.

But given the fact that it would probably end up in some type of litigation or discussion in front of the FERC or potentially even the district courts gives us enough pause and concern that we believe the FERC should look at providing certain clarity within our tariff that if indeed it decides that monetary penalties are appropriate for a not-for-profit ISO or RTO that we have the mechanism to basically recover those through our rates.

And I think that would be a two-step process there: One, to give us the capability to pass those through to an entity, a third-party entity within our marketplace that's a registered entity if they were the violator, or in a second instance, if it was the NYISO that was at fault they'd be able to pass that through a collect it on a sort of socialized basis through our rate structure.

MR. MORIE: If I could just clarify for a second. I was thinking more of the front end of this. In other
words, how would the ISO or the RTO get the dollars to be able to pay?

MR. LYNCH: That's the point. We have no dollars.

I mentioned in my prepared remarks that we work with our governance process and our market participants to establish a budget. We have a budget that basically accounts for all of our operating expense. That is approved by our board. There is no reserve. There are no funds that are sitting there for penalties.

I think there's a question mark whether you'd have some other mechanism basically to fund those.

Our problem would be is that we don't have a direct avenue basically to pay those penalties. And we'd have to start using what I would consider to be ambiguous language to basically collect funds to then pay those.

Does that answer your question?

MR. MORIE: Certainly it's helpful.

I just want to, for example, get down to the nitty gritty. Would the New York ISO have to go take out a loan or something?

MR. LYNCH: We can't take out debt without the New York Public Service Commission authority. There are operating accounts that you have for your operating reserves. But the way they are structured in our tariff
they do not look like we have the right to basically use
those monetary funds to pay a penalty.

MR. MORIE: Thanks.

MR. PINCUS: I think that PJM is uniquely
situated among the RTO and ISOs.

PJM operates, as I mentioned, under a stated rate. This construct creates a fund which in essence mimics a for-profit organization. It creates an equity of sorts. Through this fund we would be able to in the first instance at least pay the penalties out of that fund.

Of course that does result indirectly as a pass-through to customers because there's a limit on how much we can have in that fund, after which we would refund the difference to customers -- that is, members. Again, under our stated rate construct that would be the initial source. And I think under most scenarios that would probably be sufficient.

But we can't address -- I'd rather not speculate on how we would proceed beyond that.

MR. GRABLE: I think it's a very good question.

My answer is brief:

I can't tell you today how we might do it. We certainly have no budget line item that would cover a debt like that.

MR. IVANCOVICH: The Cal ISO would pay the
penalty out of its operating reserve and the following year
that would be reflected in our grid management charge. We
would basically seek to replenish the operating reserve by
passing through the penalty to our customers.

MR. DILLAHUNTY: The question depends upon when
payment is due, to some extent. If it exceeded our
operating cap there is a Catch-22 here. We must come back
to the FERC to seek permission to acquire new debt and
borrow monies. It is a hypothetical but potentially real
situation for us.

We do not have the monies or potentially might
have the monies and would have to come to you to borrow the
money to pay the penalty. Additional costs, as I mentioned
in my comments, could be that it could affect our credit
rating and our cost of capital in that situation.

MR. KOZEY: Before the 205 Act was effective
Midwest ISO's cost recovery language in its documents filed
here, its rate schedules 10, 16 and 17 talk about recovering
all costs. That's a very broad term.

We have a lot of comfort in that. Then gradually
through the rulemaking about penalties when it was suggested
that RTOs and ISOs be excluded and the Commission said no,
no general exclusion but if you had a specific cost recovery
mechanism for them then perhaps, yes, that hint specific
cost recovery mechanism for them made us concerned that it
was no longer wholly clear that the term 'costs' would cover such a penalty.

When the Commission in its other penalty-enforcing realm has recently in settled cases had folks say that the penalties that were agreed to through enforcement actions are never going to be recovered in cost of service and shan't be considered a cost, that added another element of concern for us as to whether these kinds of penalties would be treated the same way. Hence the reason for our motivation to file for a specific tariff provision to clarify this.

MR. MUSCO: Can I ask a follow-up of PJM and Cal ISO?

Steve, you said in your stated rate fund, that's where compensation packages come from and that in the event of a reliability violation the size of those compensation packages would be smaller, would that be a significant portion and would it affect the size of recovery when you replenish that stated rate fund in the event of a reliability violation?

MR. PINCUS: I think there's two separate things really happening here.

The entire operation of the RTO is funded through the stated rate. What I was referring to as the fund is something called a reserve liability fund which is a pool of
-- sort of an equity resource that's created through the stated rate mechanism. If it gets to a certain size -- and I don't remember what the dollar amount is, but if it gets beyond that there's a difference that's refunded to the members. Otherwise the pool remains in place and it can be used for, for instance, if a penalty was assessed the compensation program that we have, it can be funded through the stated rate.

But what I was referring to is I never have specific impacts or dollar amounts of how it works. But one of the key measures in our discretionary compensation programs is compliance with NERC standards. And if a scenario came about hypothetically and there was a violation the penalties assessed would have a significant impact on our discretionary compensation program and our awards at all levels of the company, from senior officers down to the lowest employees.

MR. MUSCO: Anthony, you had said that pay is directly docked for noncompliance with reliability standards. Would that have a significant impact as well in terms of what you'd have to recover from the sort of socialized recovery of your operating reserves?

MR. IVANCOVICH: I guess two concepts here:
First, as far as the incentive compensation plan, 25 percent of our corporate goals are put into the sort of
achieve excellence in grid and market operations box. Of
total -- would be complying
with six categories of reliability standards. Individual
employees' incentive compensation at the Cal ISO is based in
part on corporate goals and individual goals. As you move
from the officer level down to the individual contributed
level it depends.

The weighting of corporate versus individual
performance goals is weighted differently. So if you're an
officer or an executive you're affected more by corporate
goals, meeting the corporate goals. If you are an
individual your incentive compensation is governed more by
meeting your individual goals.

And I believe the current range, the corporate
goal weighting is 30 percent for an individual contributor,
and I believe it goes all the way up to 70 percent for our
CEO. So for our officers and higher level folks at the Cal
ISO complying with this reliability standards is a fairly
significant piece of the incentive compensation.

As far as passing through any penalties -- and
again I'm talking in the past -- our current tariff, we've
been under a regime with WECC under a reliability management
system agreement where we can be penalized by WECC for
failing to comply with WECC reliability standards. There
are several categories of those.
Again, I think it's been a very limited occurrence in the past where this has occurred. But the practice would be that we would take it out of our operating reserve, which contemplates that that's where penalties would be paid out of. And then in the following year's GMC we would basically be filing to replenish that operating reserve.

I guess one of the concerns that I have is that our tariff specifically refers to WECC penalties. And this far pre-dates -- it goes back to about 1999 and pre-dates the National Reliability Standards. So one concern we have is whether our current tariff provision covers the new reliability standards or not.

And for the reasons I gave in my presentation we believe we ought to be able to pass through any penalties for violating national reliability standards. And it's our firm belief that we've got the incentive to comply with those standards given our incentive compensation program.

MR. HEGELE: Let me just follow-up on that for a moment because Vincent started down a line I was thinking of.

We're talking about incentives. And the first thing I think in a for-profit company that goes to the shareholders, the only incentives you have here is the executive compensation, the goals and what have you.
What happens to that money? I don't know how these programs are set up. And I can ask all of you this: Is it such that whatever the percentage is -- 20 percent is reliability standards -- you meet the goal and you get the money.

What if you don't meet the goal? Is that money returned to the customers? Can that money be used because you did well on the market side and the money is slushed over to that side, for instance? Is it one big pool of money or is it, you can get this one but you can lose this one and there's no returning it?

And lastly, is this public information? Does the public see the results of this?

I'd like to go down the line, if we could.

MR. LYNCH: We didn't really talk about compensation tied to reliability standards in our comments. And I do think it's a slippery slope.

When you look at taking compensation and trying to use it as some mechanism in the form of penalties, I do think -- I'm probably the only non-lawyer here -- but I do think there are certain precedents set in that nature that it's not an equitable type of arrangement. That may be a shortcoming on my part.

But under our incentive compensation, which is for all of our employees, we work with the market
participants and put together a list of goals that as a corporation we have to meet over the year, very similar to what was discussed before. There's a certain part that are these corporate goals and then each individual has individual goals. The corporate goals are set up so that if you meet one of the goals there's a certain percentage payoff. If you don't you lose that money.

Essentially we just wouldn't collect it under Rate Schedule 1. It's not a pool of money that's sitting there that you're going to throw in someplace else. Basically it's an incentive program to set up certain corporate goals and individual goals to have you performance managed with all your employees. But we do have customer satisfaction; we do have ops goals that tie into the performance standards. If we do not meet those -- let's say they're ten percent or 100 percent payout, you would lose ten percent of that payout and that would be the penalty you'd pay out on the corporate goal.

MR. HEGE: The money essentially would be returned to the customers.

MR. LYNCH: It wouldn't be collected, essentially, through rate schedule one. The incentive is just all built in our budget.

I think it's very important to know that not only our corporate incentive goals, which were agreed to by our
market participants, but our budget is basically worked through with out market participants and they provide us an advisory vote that goes to our board to basically approve our budget. So far in our seven or eight year history the board has always agreed with the market participant advisory vote and put in a budget that is exactly what the market participants expect.

MR. HEGERLE: And the market participants see the end result?

MR. LYNCH: They get to see the results.

We're very transparent as we go through the year on our progress, and also at the end of the year. They're very aware of how we are rated on the corporate incentive and how we did against those goals. And they actually use that the following year to basically look at trying to raise the bar on our performance on the new market goals.

MR. HEGERLE: The rate folks may know that. But does that information come to the Commission in some form?

MR. LYNCH: It's available on our website. It's very transparent.

MR. HEGERLE: Thank you.

Steven.

MR. PINCUS: As I said, under our stated rate there's a reserve liability fund created. There's a fixed operating dollar amount that we operate under, which
1 includes the total compensation.
2 So under your scenario if we fail to meet a
3 standard and the compensation was not paid out as a result
4 then theoretically -- it's hard to say exactly how it works
5 because when you're talking about that we're paying out a
6 penalty, so it would impact our overall operating costs.
7 But the money would not be paid out and therefore would be
8 kept within our fixed rate, and creating -- staying within
9 the pool and theoretically allowing us, if the stated rate
10 pool is exceeded, to refund back to our members the
11 difference under the stated rate construct.
12 This is a transparent process. I believe that
13 our stated rate is reviewed through our finance committee
14 and the board, and it's very visible to our members.
15 MR. HEGERLE: It all sounds like it's above or
16 below a cap is what you're really worried about. Do you
17 mean that dollars can be used over here instead of over
18 here?
19 What I'm trying to explore is the notion that the
20 RTOs and ISOs have no incentive to violate a standard. I'm
21 trying to balance what if there was a market goal and by
22 violating a standard we can meet the market goal.
23 Do the executives in the end come out better off
24 by violating the standard because they meet the market goal?
25 From what Mark said, no, they wouldn't because they can only
1 earn so much on the market portion; they'd lose a portion on
2 the reliability standards portion.
3 MR. PINCUS: I can't see any scenario where our
4 officers or employees would benefit from violating a
5 standard. It's not even conceivable.
6 I'm not sure if I'm even understanding the
7 question that you're presenting.
8 MR. HEGELE: Just if you have a variety of
9 incentives and a pool of money, if that pool is one big pool
10 and it can be -- I can give you money for this or I can give
11 you money for that; if you don't get it here I can bump this
12 number up and give it to you there.
13 MR. PINCUS: It doesn't operate that way.
14 MR. LYNCH: Just to follow-up, that part of your
15 question, I think it's pretty important to note that if the
16 NYISO violated a reliability rule it would be a mistake;
17 it's not a strategy. There is nothing that we have either
18 in our goals or construct that gives us any incentive to
19 violate a reliability rule.
20 Our first goal and mission is the safe and
21 reliable operation of the bulk power system. Truly, if
22 there's a violation it's a mistake. There is no mechanism
23 or means or even conceivable sort of tie to a strategy that
24 would put in place that type of construct.
25 MR. GRABLE: ERCOT certainly has corporate and
individual goals related to achieving full reliable operations. We do not have significant incentive compensation at this point in time only for the CEO, and that is overseen by our hybrid independent stakeholder board.

Since we do not have incentive plans tied to reliability I can't answer your question directly. I can tell you on your underlying concern there is never a circumstance under which any employee of ERCOT would be incented to violate a reliability standard for market or any other reasons.

MR. HEGERLE: Because they don't have an overwhelming market incentive. That's all I'm trying to say.

I would never suggest that anyone would desire to do that if you're balancing these; that's kind of what's being implied for others, for non-independents.

Anthony, anything?

MR. IVANCOVICH: I don't think we have any incentive to be violating a reliability standard in order to benefit some other part of the corporate incentive compensation.

You asked about flow-through mechanisms under the ISO's GMC methodology. Now to the extent we have excessive funds and what year they get passed through the GMC in the
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1 following year, you know, market participants are generally
2 kept whole from year to year and we're not in a position
3 where we can be amassing a large war chest through the years
4 to pay off penalties or otherwise.

MR. DILLAHUNTY: Performance based compensation
5 is no guarantee at SPP. And certainly reliability is a
6 component of that.

This is all done very visibly. It is included in
7 our budget that our members' committee and board of
8 directors vote on and then at the time of the payout each
9 year the recommendation comes through the committee
10 structure, voted on by the members' committee and the board
11 of directors. And I'm quite certain that there would be no
12 incentive for the violation of a reliability standard to
13 enhance compensation in any way.

MR. HEGELE: But the incentives are looked at as
16 a whole, performance as a whole; not in pieces.

MR. DILLAHUNTY: We do have standards for each of
18 the pieces including reliability standards. They are looked
19 at individually in determining the percentage that could be
20 allocated to the performance-based compensation. So it is a
21 whole, but it's look at as the individual parts.

MR. HEGELE: If the reliability portion wasn't
23 met that particular year for whatever reason would that be
24 lost? It's a little unclear. That's what I'm asking. It's
MR. DILLAHUNTY: I believe it's unclear in my mind, at least, but I think that they would be lost.

MR. HE3GERLE: Thank you.

MR. KOZHEY: The various components of the incentive compensation are established by the human resources committee of our board. It does that in open meetings. It will have reports from staff of where we are during the year.

We'll have an October public meeting; it will be on agenda. It will be reported out. And then either later this fall or early next year we will share with the stakeholders what changes, if any, we want to ask the HR committee to make to the compensation structure. Annually the committee invites their comments.

Unlike SPP the members don't vote on what it's going to be, but they get to tell the committee and the board their comments. It's not a pool of money in our circumstance. So if one area's dollars were not achieved, they're gone. It doesn't increase any other fund to be available.

I was trying to remember the kind of market goals we had. And just offhand they're like systems performance goals: keep the IT systems at 99-point-something-something-percent of availability; make the day-ahead market
close by the tariff goal time of four o'clock. So it was hard for me to imagine, Mark, how any one part of the company that in real time was dealing with reliability could imagine they were helping some other goal be advanced by committing a violation. I can't imagine that.

MR. HEGERLE: Thank you.

MR. THOMAS: I apologize. We've talked of one side of the cost. I want to shift the focus to the other side of cost. It was mentioned by several on the panel, whether it's a root cause study or the ERO should figure out who was the responsible party, the EROs are not issuing costs and many RTOs are agreeing to pay the standard funding costs. I wonder if anybody on the panel can just talk about how they envision these root cause costs, these extra litigation costs possibly, how would those be passed on?

Are we talking socialized costs; are we talking the responsible party eventually pays all those costs? What happens if the ERO is unable to do that? Do we lose that advantage of funding the culpable party?

MR. LYNCH: I know exactly where you're going. But as long as it's a registered entity the regional entity of the ERO would have the right to assess the penalty and get it directly from them as opposed to run it through an
ISO RTO.

If there was a question on an unregistered entity I think the regional entity, the ERO is going to have to answer that. I'm not sure if they deal with that.

I don't know if that's your question.

MR. THOMAS: I'll try and beef it up a little bit.

Not only is there just the penalty but there's costs. There could possibly be costs associated by the ERO to investigate who was the cause of the penalty. Let's say the penalty was the standard million dollars. That may not include the cost of the ERO to investigate the penalty.

Where do you envision who should pay for the investigative costs?

MR. LYNCH: I'm not sure I'm qualified to say that. I would assume the ERO would have to include that in their enforcement mechanism and recovery just like if you litigate an action the parties that litigate it would have to include the cost of recovery in that action.

MR. PINCUS: Actually, when I first heard your question I thought you were talking about the cost the RTO itself would incur participating in that process. But the answer to the question seems to indicate that your question really went to who's going to pay the ERO cost. And I think I agree, the answer is that should be part of their
They're going to be conducting these investigations. They're going to be looking at violations of standards. And this would be an incremental cost. I think it's an important component of their process. Perhaps even if you're talking about the RTO costs, that would just be part of our operating costs and our expenses that we fund day to day.

Again in PJM's case it's through the stated rate.

MR. GRABLE: I think it's a good question.

In many investigations the EROs are going to face perhaps finger-pointing and parties attempting to determine who in fact is responsible, whether they're registered or not. Beyond that I really don't feel qualified to answer a question on the ERO or E-budgets or cost recovery.

MR. IVANCOVICH: We think we'd have a situation where the ERO or the regional entity is already investigating the incident; under that scenario it doesn't make sense to have a proceeding going on at the ERA regional entity level and another arbitration or other type proceeding going on at the ISO/RTO level to discern who the culpable party is.

I think we'd all be better served by doing it in once place. It would eliminate any overlap and duplication and it would certainly be a lot more administratively
efficient. And under that scenario I think it would be appropriate for the costs to be passed through the ERO or regional entity operating budget.

MR. DILLAHUNTY: I believe our costs associated with any reliability penalty at the RTO level would be general costs and not specifically assigned. We have no mechanism to assign a cost to a specific entity. And many things that we do involve the market segment or involve a limited number of our members, et cetera. So it would be a general expense.

MR. KOZEY: For how the ERO intends to do things, I happy that Mr. Whiteley is on your third panel.

I'm not qualified to answer that. Much like Les just said, we only break down our cost recovery between three schedules. Attorney time or outside counsel time or the expenses we'd incur would just be recovered through those mechanisms. They wouldn't be charged to any individual company.

MR. LE KANG: I'd like to thank the six of you for providing your remarks and responses to Staff's questions.

We're going to take about a ten-minute break while the second panel gets seated.

Thank you very much.

(Recess.)
MR. LE KANG: If we can find our seats again, please.

(Pause.)

MR. LE KANG: Okay, folks. We're ready for the second panel now.

As I mentioned earlier, our second panel consists of representative entities potentially subject to paying penalties incurred by the RTOs or ISOs if a reliability standard is violated and the penalty is passed through.

We have six panelists again. We're going to start on the left with Dale and go right down, the same process. State your name first and you can make your remarks; then we'll follow it up with Staff questions.

Dale.

MR. LANDGREN: Thank you, Don. Thanks. ATC appreciates the Commission addressing this.

I'm Dale Landgren, Vice President and Chief Strategic Officer of American Transmission Company. We appreciate your addressing this topic. We have filed remarks before and we will continue to do that.

We view two central issues here: First, what is the appropriate role of the RTO in the new mandatory rate reliability regime. We already heard a lot of discussion about that from the first panel.

The second is how RTOs will be held accountable
for their reliability responsibilities.

In regard to the issue of roles, it seems to us the Commission has been very clear. In Order 672(A) on the role of RTOs relative to that of the electric reliability organization and the regional entities, basically -- and I quote from that order:

"The Federal Power Act makes the ERO and the regional entities responsible for establishing and enforcing reliability standards while making users, owners and operators of the bulk power system, including ISOs and RTOs, subject to penalties for failure to comply with these reliability standards."

End quote.

The Commission was also clear in Order 693 -- and again I quote:

"The organization that registers with NERC to perform a function will be the responsible entity. And while it may delegate the performance of that task to another, it may not delegate its responsibility for ensuring the task is completed."

End quote.

Accordingly, RTOs should not be placed in the position of that of an enforcement entity with the authority to assign penalties to the parties the RTO determines to be in violation of
specific reliability standards. This is specifically the
role of the ERO, the regional entity, and this Commission.

RTOs should be viewed as any other user, owner or
operator of the bulk power system and be held accountable
for the reliability functions for which they are registered
and the reliability standards applicable to those standards.

Frankly, I was concerned, based on some of the
questions and answers from the first panel, that some seem
to believe that independence guarantees compliance. That
implies that all non-compliance will be caused because of
purposeful behavior on the part of somebody.

From what I have seen in the industry and my own
company specifically, more often than not you're going to
get non-compliance because of a lack of management attention
to process or focus. It has nothing to do with independence
and the ability to game, if you will, the system. Those
things can cause non-compliance. And we strongly believe
that all registered entities need to have that same
accountability and penalties in order to focus their entire
staff on those issues.

NERC and the regions are the enforcement
authorities and it's their responsibility to investigate and
determine violations of reliability standards. As part of
this process RTOs that are assessed reliability penalties,
as with all other registered users, owners and operators of
the bulk power system, will have due process options to make its case on whether a penalty is warranted or if they believe, as you heard the questions on the first panel, if they believe someone else is accountable they can raise the issue during that hearing process.

That includes the ability of the RTO to contest an alleged violation and proposed penalties, to present information supporting its contention in a hearing before the regional entity alleging the violation. The RTO also has the additional option of subsequently appealing a regional entity's decision to NERC and to the Commission.

Ultimately ATC believes that the Commission should ensure that any reliability penalty cost recovery mechanism will not treat RTOs differently than any other registered user, owner or operator of the bulk power system and will not place these organizations in a role that could undermine the ERO and the regional entities' enforcement process. However, as some RTOs are non-profit organizations, holding the RTOs accountable for their reliability obligations through the use of monetary penalties raises the issues of the organizations' ability to pay without inhibiting their ability to fulfill such core functions as regional transmission operations and wholesale market operations.

ATC would strongly oppose using the money that
people have budgeted to provide regional operations or provide service being redirected from their intended purposes, as this in itself would pose a threat to the bulk power system reliability. The situation necessitates the RTOs to generally pass through the cost of these reliability penalties to their customers. However, this should be done through a filing under Section 205 of the Federal Power Act, seeking Commission approval to pass through the penalty costs.

Each time an RTO wants to generally pass through penalty costs to its customers and after FERC approval, we believe it would be appropriate for the RTO to uplift the penalty cost to all users of the grid. In such a filing the RTOs would be required to also include their plan for correcting the problem that caused them to be in violation of the standard.

We don't believe there should be a tariff change to allow automatic pass-through of these fines. The only time an RTO should be allowed to directly assign penalty costs to a particular party should be in cases where the RTO contracts with other entities to perform a reliability function for the RTO.

In these cases if the RTO was penalized because the other entity did not fulfill its contractual obligation the RTO should recover the penalty cost from that entity per
the contract. In fact ATC thinks it is incumbent upon the RTO to ensure that the agreements they enter into with other entities to perform reliability functions for the RTO enable penalty cost recovery when the other entity doesn't fulfill its obligations.

In any event, requiring RTOs to seek Commission approval to generally pass through costs for reliability penalties except in cases where RTOs can recover those costs from particular entities per a contract would be a way for the RTO to pay for the reliability penalties without jeopardizing their operations while creating a mechanism through which RTOs would be held accountable to the Commission and those entities that must pay for the RTO penalties.

Thank you again for addressing these issues.

MR. LE KANG: Thank you, Dale.

Brian.

MR. THUMM: Thank you.

Good morning. I am Brian Thumm, Manager of ERO and Regional Affairs for ITC Holdings. I appreciate the opportunity to be here this morning.

The regional transmission organizations and ISOS, there are essentially two types of non-compliances that they may incur: those costs by the member entities of the ISO and those which are directly attributable to the ISO itself.
Each of these two types of non-compliance want separate treatment within the constructs of the compliance enforcement program.

In the first instance the ISO was found to be non-compliant with a reliability standard due to the actions of its members. It is possible that these members are registered entities for some function -- for example, a generator -- but not for the function being assessed -- the penalty, for example, the balancing authority.

In instances where the member entities are identifiable it is appropriate that any monetary sanctions be borne by the members determined to be at fault. This is most appropriately handled through member agreements between the ISO and its members, not through a Section 205 filing before the Commission. It is important to note that the ISO is not passing through the non-compliance per se, but rather the financial obligation for the monetary sanction.

In order to do so, however, it is incumbent upon the regional entity -- in our case reliability first -- to fully document the specific identification of the members at fault in its findings of non-compliance. The regional entity's determination will be the only investigation into the circumstances of non-compliance since the authority is not vested with the ISO.

In instances where definitive identification of
contributors to the non-compliance cannot be made it would then be appropriate to collect the monetary sanctions from all members of the ISO. Again, this is most appropriately handled through member agreements between the ISO and its members.

It is conceivable that an ISO can be found non-compliant with reliability standards for which it is solely responsible. One that comes to mind is the requirement to provide training to its operations personnel. In these instances it would not be appropriate to pass through the costs of non-compliance sanctions. These non-compliance penalties must be borne solely by the ISO.

Non-compliance penalties need not be monetary sanctions. The NERC rules of procedure describe non-monetary sanctions such as placing an entity on a watch list imposed on major violators and placing limitations on activities, functions, or operations. Peer pressure such as the Nuclear Regulatory Commission's watch list has long been an effective strategy in the nuclear industry in lieu of setting desired behavior amongst senior management. Increased audit frequency and dedicated compliance monitoring for an ISO could also be enacted as part of a non-monetary sanction against an ISO.

These types of non-monetary sanctions are most effective when coupled with the risk of loss. In the
nuclear environment escalation of watch list status results in a plant's risk of losing its operating license. Analogously in our industry escalation of a watch list status must result in an entity's risk of losing certification for the functions it performs.

This is not to rule out the potential for monetary sanctions against an ISO. The NERC rules of procedure also invoke an ability to pay clause in the treatment of monetary sanctions. Insofar as an ISO maintains an administrative funds account for various incidentals -- management compensation and incentive pay -- these administrative funds can also be used to pay small monetary sanctions for reliability standards non-compliance.

We do not advocate decimating such accounts solely for payment of monetary sanctions. But we feel there's an opportunity to use administrative funds in conjunction with the ability to pay concept to craft a reasonable and just means for an ISO to pay small monetary sanctions. There may also be methods with which to hedge the risk of monetary sanctions in the event the sanctions exceed the ability to pay and where NERC and the regional entity refuse to reduce the financial obligations of the ISO.

In conclusion, I wish to reiterate two salient points. First, there's an opportunity to segregate non-
compliances for ISOs into two categories: those for which it is solely responsible and those for which its members are responsible. The sanctions for each of these two categories need not be identical and may involve both monetary and non-monetary sanctions.

Second, in order to properly describe the obligations for any sanctions regional entities must necessarily identify specific contributing factors and entities when documenting the circumstances surrounding the finding of non-compliance of an ISO.

I look forward to your questions. Thank you.

MR. LE KANG: Thank you, Brian.

Maureen.

MS. BORKOWSKI: Good morning. My name is Maureen Borkowski. I'm Vice President of Transmission for Ameren Services Company in St. Louis, Missouri. I appreciate the opportunity to be here today.

I am here today representing the vertically integrated transmission owners and the Canadian coordinating member of the Midwest ISO, better known as VITOs. These comments are not necessarily reflective of the individual opinions of each transmission owner, but are a compendium of member opinions.

I'm here today to express the VITOs thoughts on what we hope and believe will be the unlikely event of
assigning cost responsibility for penalties incurred by the Midwest ISO for violations of reliability standards. I will respond to the topics posted by the Commission to this panel in the reverse order of that listed in the final notice and agenda.

First, should an RTO or ISO be permitted to directly assign to specific customers, market participants or members reliability penalties assessed against it. The VITOs offer a resounding yes to this question.

It is essential to principles of justness and reasonableness that recovery of penalties first be assigned to those who caused the penalty to be incurred. For example, the Midwest ISO plans to operate an integrated energy and ancillary services market for which it will be the balancing authority.

One of the ancillary services to be provided in this market is regulation service. Control performance standard requirement number of BAL-001 standard requires each balancing authority to keep its area control error within a calculated bandwidth for at least 90 percent of the ten minute periods of any month. If the Midwest ISO were found to be in violation of this requirement it is entirely possible, even likely, that the violation would have been caused by the non-performance of one or more of the generators who was providing the regulation service in the
1 market. The violation-causing generator or generators should be assigned the cost responsibility for any penalty assessed to the Midwest ISO for this violation.

2 As such, it is essential that the regional entity investigating the violation perform a detailed analysis not only to determine the existence of the violation but to determine the entity or entities that actually caused the violation, with sufficient detail to assign cost responsibility for the penalty. The assignment of cost responsibility for any penalty would be in addition to any cost responsibility that the entity may have under the Midwest ISO tariff for non-performance, as these costs are only assessed to make the market whole.

3 This leads to the second part of the question posed by the Commission: How should duplicative proceedings be avoided and due process ensured.

4 The regional entity investigating the violation may need to issue multiple notices of alleged violation to the Midwest ISO and to the entities that allegedly caused the violation to occur. This will ensure that no duplicative investigation is required and that the Midwest ISO and the identified entities have the opportunity for due process under NERC procedures.

5 As I will describe in more detail, the Midwest ISO should also be required to make a filing under Section
205 of the Federal Power Act and any equivalent Canadian regulatory filings before recovering the costs of any penalty from any of its members or customers. This, too, would afford the entity due process.

The Commission also asked for comments on what source of funds should be used for payment if an RTO or ISO is not permitted to pass on reliability penalty costs assessed against it. As maintaining reliability is a core function of an RTO or ISO, many of the VITOs feel that the Midwest ISO management should bear cost responsibility for violations of reliability standards that were not caused by others.

I would note that the VITOs do not consider this an issue to be addressed formally by the Commission. We offer these comments for the benefit of the Midwest ISO's board of directors who approve the incentive compensation plan. We encourage the board to specifically address the issue of standards violations and any associated penalties in the incentive comp plan.

Generally the VITOs believe that if the Midwest ISO violated a reliability standard whose compliance was entirely within the Midwest ISO's control, any penalty should first be absorbed by the Midwest ISO's management incentive compensation plan.

Finally, the VITOs responded to the threshold
question of whether an RTO or ISO should be permitted to allocate to its customers or members reliability penalties assessed against it. The VITOs believe that a generic assignment of penalties to customers or members should always be the last resort.

Further, any penalty that the Midwest ISO seeks to recover, either generically or through specific cost assignment to the causers, should require a Section 205 filing with the Commission. As the incidence of any standards violations by the Midwest ISO and resulting penalty recover should be rare, this should not present an undue administrative burden.

The 205 filing should specify recovery either from specific violation-causing entities or under Schedule 10 -- which is the schedules assessed to load -- or Schedule 17 that affect all market participants, depending on the nature of the violation.

A requirement to make the Section 205 filing to recover any penalties will ensure that customers and members of the Midwest ISO have adequate opportunity to provide comments on the appropriate tariff recovery mechanism.

I appreciate the opportunity to address you today. That concludes my remarks.

MR. LE KANG: Thank you, Maureen.

Tamara.
MS. LINDE: Thank you.

Good morning. My name is Tamara Linde, Vice President of Regulatory for the PSEG Companies. Today I'm speaking on behalf of the PJM transmission owners.

The PJM transmission owners appreciate the opportunity to participate in this technical conference and offer our collective views -- not necessarily the views of every individual PJM transmission owner -- on the assessment of ERO penalties within the ISO/RTO model.

Let me start by saying that reliability of the electric system is fundamental to the success of our industry. The Commission, the reliability entities as well as the industry participants have dedicated significant time and effort to develop the NERC reliability standards.

Now that many of those standards are complete and have been approved by the Commission and the industry members, including RTOs, understand what they are responsible for, we must ensure that the processes are in place to cause proper assignment of any potential NERC penalties within the RTO/ISO structure in a manner consistent with the intent and purpose of the reliability standards.

According to the NERC sanction guidelines the key effects of enforcement activities are to promote compliance behavior, deter repeat incidents, and prompt corrective
behavior. The challenge before the Commission is how best to achieve these key effects in RTO environments where, one, RTOs may not bear any of the costs of these penalties on account of their rate structures or, two, members may be directly assessed penalties where they were only following the directions of the RTO or actually were relying upon the RTO to perform a particular task.

Today I will review the transmission owners' view of the specific questions posed by the Commission for this panel and also suggest that the use of non-monetary penalties for RTOs or ISOs such as PJM would better achieve the intent of the NERC sanction guidelines. First let me turn to the question of whether the PJM agreements provide for the allocation of responsibility of NERC compliance matters.

The PJM transmission owners do not believe that there is any confusion regarding the allocation of responsibility for NERC compliance matters as between PJM and the PJM transmission owners. To ensure that there was no confusion PJM and its transmission owners recently completed a matrix, a very detailed matrix, which is posted on the PJM website that sets forth our respective responsibilities with regard to each and every NERC standard. Additionally, both the consolidated transmission owners agreement and the PJM operating agreement clearly
delineate reliability-related responsibilities.

The TOA and the OA are both FERC-approved documents that must be complied with. While the responsibilities for compliance are well sorted out, the PJM documents and agreements do not currently include any clear process for recovery or assignment of potential NERC penalties in the event that there is a violation either by PJM or by a member relying upon the direction of PJM.

Specifically there are two scenarios where this is evidence. The first scenario is where PJM is the registered agent for a NERC-compliance purpose but in satisfying some of those obligations relies upon members to perform an important or critical task to satisfy that requirement.

Conversely, a member company could be assessed a NERC penalty as a registered transmission owner, generation owner, generation operator, or et cetera, where PJM performs a task or tasks within that function that the member relies upon to meet its NERC obligations. An example of this is standard FAC 001-0, which applies to transmission owners and requires, among other things, transmission owners to supply NERC with voltage reactive power and power factor control analysis.

The transmission owners rely upon PJM to perform these analyses. In the event that the analysis is performed
incorrectly or is otherwise deficient, the transmission
owners could be found in violation of the standard and
assessed penalty. Although the PJM-TO matrix clearly
document the responsibilities for this task -- and we
believe correctly so -- there is no provision in the tariff
or agreements that would hold the member financially
responsible for performing the important task where PJM is
held to be the violating entity, or, conversely, where the
member is held to be the violating entity but relied upon
PJM.

Let me talk about the mechanics of penalty
assessment.

If an individual member is responsible by its
actions or inactions for a violation that member should be
held financially responsible for the associated penalty and
the cost of the penalty should not be spread across all PJM
membership through a pass-through mechanism. There may be
many approaches to achieve this objective.

One approach that the PJM transmission owners
have been considering is to add a specific NERC penalty
indemnification provision to the PJM operating agreement.
Indemnification language that would permit the assignment of
penalty costs to the appropriate entity in accordance with
their respective responsibility could be utilized to ensure
that the proper party is responsible for payment.
Indemnity provisions already exist in the RTO context with provisions that generally cover indemnification for physical damage or other liability. Appropriate indemnification language could potentially be drafted to be used for a NERC penalty assessment as well. However, if such an approach is used it's critical that two core principles be followed in taking this approach.

First, the RTO should not have the right or ability to make a determination as to whether a finding of non-compliance is attributable to the actions of a particular member or group of members. The converse is also true: It should not be left up to the PJM transmission owners who is assessed a penalty to say that PJM was the cause of the penalty. Rather, this determination should be made only by NERC as the ERO or the regional entities such as RFC. This determination should be performed as part of the primary investigation that is ultimately filed with FERC.

The second critical point is that the RTO member who is alleged to have caused the NERC standard violation must be given notice immediately or as soon as possible so that that party can participate in any investigation at the earliest opportunity and must be given full rights to participate in the proceeding at all levels, including judicial appeals.
The entity must have notice and an opportunity to be heard consistent with due process requirements. Appropriate non-public notice provisions must be crafted to ensure that this process works properly while maintaining requisite confidentiality, which is essential during these types of investigations. If the party is not given these due process rights the indemnification approach simply cannot be applied.

During panel one there was a discussion raised about whether the ERO could actually -- or the regional entity could actually include a non-registered entity in this process. Some of the PJM transmission owners have recently submitted a proposal to the RFC that would allow joinder of a non-registered party for this exact purpose. Our understanding is that is currently pending before the RFC; it has not yet been acted on.

In circumstances where responsibility for a violation cannot be directly assigned to a PJM member or members -- for example, where PJM is responsible for a violation because of its actions or inactions or a PJM member has acted at the clear direction of PJM -- then a mechanism is needed to ensure that PJM will be held accountable. The question is how to hold an RTO accountable.

Generally, as you heard from panel one, RTOs such
as PJM do not have substantial non-member funds that can be used to pay NERC penalties but rather they are pass-through entities with member funds funding their financial needs. There are two paths the Commission could take to address this reality.

First, they could use non-monetary penalties to address the situation where the RTO is actually the cause of the violation. Where the RTO such as PJM does not have the wherewithal to pay a significant NERC penalty and will likely seek to pass it through, it is questionable whether the intent of the NERC sanction and guidelines would be achieved by simply allowing that pass-through.

There are numerous non-monetary penalties, including the development of mitigation plans. I think the NRC watch list was an excellent idea. Increased FERC oversight, audits, and additional reporting requirements, as well as many other mechanics could be used to address such a scenario. These non-monetary penalties could be geared to improving NERC compliance while avoiding the creation of new material costs for RTO members.

If FERC does determine that non-monetary penalties need to be imposed on an RTO for a non-RTO-caused violation penalty costs should be spread across membership to the broadest extent possible to minimize impact on RTO members. This would include an allocation to the full
membership body and reliability related service customers. Costs should be passed along to all applicable entities on an equitably-weighted basis.

Even in such a situation, however, if membership is going to be held financially accountable for RTO violations the RTO board of directors should establish transparent provisions to incorporate NERC standard compliance as a significant part of RTO performance management system. The RTO's internal matrix should be designed to maintain reliability standards compliance and reflect the severity of any violations and the factual circumstances presented.

Thank you. That concludes my prepared comments.

MR. LE KANG: Thank you, Tamara.

Bary.

MR. WARREN: Good morning. Thank you for the opportunity to be a panelist for this FERC technical conference. My name is Bary Kirk Warren, currently the Director of Transmission Policy and Reliability Compliance for the Empire District Electric Company, referred to as Empire.

Based in Joplin, Missouri, Empire is a small investor-owned balancing authority generation owner-operator, transmission owner-operator, and load-serving utility providing electric, natural gas and water service
with approximately 161,000 retail electric customers and
four wholesale electric customers in southwest Missouri,
southeast Kansas, northeast Oklahoma and northwest Arkansas.
Empire manages over 1400 megawatts of generating resources
and 1200 miles of transmission lines in the Southwest Power
Pool Regional Transmission organization region, referred to
as SPP.

Empire is one of the founding members of the SPP,
which came into existence in 1941 and became a FERC-
recognized not-for-profit jurisdictional regional
transmission organization in 2004. Empire is actively
involved in and/or monitors at least 17 SPP stakeholder
committees and task forces.

Empire is a party to a FERC-approved SPP
membership agreement and balancing authority SPP agreement
referred to as Attachment AN in the SPP open access
transmission tariff, which generally discusses the role and
responsibilities of the SPP in an SPP balancing authority
related to SPP energy and balance services market with
agreement of the SPP RTO to address provisions for the
recovery and allocation of financial penalties imposed by
FERC, the ERO, or a regional entity on Empire or other
balancing authorities for NERC mandatory reliability
standard violations resultant of the SPP RTO action or
inaction from the operation of the EIS market. That is
Section 7 of Attachment AN.

In responding to the Commission's questions Empire has discussed the key issues with other investor-owned utilities in the Southwest Power Pool, which serve over 75 percent of the load in the footprint. Many of these members, including Empire, are in agreement with the SPP RTO that monetary penalties should not be an enforcement option for non-profit FERC jurisdictional RTO ISOs.

To be clear on our position, such exemption from financial penalty should not apply to any non-profit entity but only applied to non-profit jurisdictional RTOs.

In the event the Commission does allow financial penalty assessments to non-profit jurisdictional RTOs then we believe that the root causes of the violation should be identified through the formal due process.

If the RTO is determined to be in violation in whole or in part that warrants a financial penalty. Such penalties should be assessed only after non-financial penalties or sanctions have been unsuccessfully imposed.

If the violation is a repeat offense and/or the violation is due to gross negligence or willful misconduct of the SPP RTO, if -- and once a non-profit jurisdictional RTO is subject to penalties of a confirmed violation, the penalty should be passed through after a formal proceeding before this Commission to the RTO members and
reliability related service customers of the RTO through a membership agreement, bylaws or services agreement such as the special regional reliability organization contract service agreement that the SPP has with the Southwest Power Administration or other reserve sharing services agreements that SPP has in place.

I emphasize that the allocation of such penalties should not be allocated to only RTO tariff customers. In fact, it is my understanding that within the SPP the SPP operates a reserve sharing program in which there are 21 entities participating. Of those 21 entities receiving reserve sharing service, 19 of the balancing authorities are SPP members but only 11 of those balancing authorities have placed their facilities under the SPP open access transmission tariff.

The allocation methodology of financial penalties to members and reliability related services customers should be based on an equitable load-weighted generation injection and number of members or customers formula, possibly similar to SPP's withdrawal obligation method described within its bylaws. The amount of such allocation to members and customers most likely will be an unbudgeted variance expense for that year the penalty is assessed.

Since the members and reliability related services customers of a non-profit RTO pay all expenses,
including salaries and bonus incentive compensation for RTOs, we believe the Commission should endorse or possibly provide guidance on three important governance related issues:

First, since most RTOs compensate officers, department heads and professional employees in a similar or even more generous manner as for-profit organizations, excluding stock options and allocations, we believe RTO personnel should also have skin in the game for poor performance that leads to monetary fines to the RTO members. RTO personnel's incentive compensation potential and pay-outs should be at least partly subject to NERC compliance results and performance. Such an explicit endorsement from the Commission would give guidance to RTO governance and compensation committees to include such performance measures which effectively should save customers dollars through effective compliance practices or some reduction in future O&M expense for the savings carry-over.

Second, Empire believes that the endorsement from the Commission of a hybrid oversight committee made up of at least two independent directors, two member representatives from the transmission-owning sector, and two member representatives from the transmission-dependent sector of the SPP RTO would be appropriate. Such a hybrid committee would provide independent business and electric industry
experience to better serve the members to achieve greater accountability from RTO management for reliability compliance. Such a hybrid committee would also be instrumental in investigating and developing the decision to appeal the finding of RTO non-compliance and mitigation plan implementation.

Third, the assessment of penalties should reside with the Commission, NERC, the ERO and/or original entity. The RTO should not have unilateral assessment authority unless explicitly ordered by the Commission on a case by case basis to allocate some or all of the penalty costs to RTO members and reliability service customers upon completion of the appropriate due process.

In conclusion, because members and reliability service customers of a non-profit jurisdictional RTO ultimately pay all expenses, including any compliance penalties, it seems appropriate that corrective action incentives should be in the form of non-financial sanctions or market service limitation. If such a financial penalty is assessed it should be assessed resultant of a proceeding to the RTO member and reliability-related services customers based on an equitable allocation method based on a load generation and number of customers methodology.

Thank you for the opportunity to participate in
this important technical conference. I welcome any
questions or comments.

MR. LE KANG: Thank you, Bary.

John.

MR. ANDERSON: I'm John Anderson, President and
CEO of the Electricity Consumers Resource Council, or ELCON.
We are the national association of large industrial
electricity consumers, and I believe the only end-user
consumer group represented today

But we do appreciate very much the opportunity to
be here.

I have five points I would like to make today.

Number one, the current NERC process for assessing penalties
makes sense to us. NERC has established a fair, open, and
inclusive process to register users, owners and operators
that can materially impact the bulk power system.

ISOs and RTOs rightly are included in the
registry for many reasons. NERC establishes, subject to
FERC approval, mandatory reliability standards that may
involve penalties, sanctions, and remedial actions,
including monetary and non-monetary penalties assessed t
those responsible for non-compliance.

NERC can find an ISO or RTO responsible for non-
compliance and an ISO or RTO can appeal any NERC finding of
non-compliance.
Second, MISO's proposed process for dealing with pass-through of non-compliance costs is inappropriate. MISO proposes to identify the specific tariff customer or customers responsible for the violation. If MISO is unable to identify the violator the penalty costs would be allocated to all MISO customers. This proposal holds MISO harmless for any violations of NERC standards and, as I said, is therefore inappropriate.

Third, ELCON believes that no penalties assessed to an ISO or RTO should be passed through to either the ISO or RTO members or to customers. As long as NERC does its job correctly -- and I emphasize that -- as long as NERC does its job correctly -- NERC and the regions, I should say -- NERC will assess penalties to any ISO or RTO member or tariff customer directly, not through the ISO or RTO.

Again, as long as NERC does its job correctly any NERC penalty assessments to any ISO or RTO is because NERC has demonstrated that the ISO or RTO itself is the entity in non-compliance. Any ISO or RTO can, of course, appeal this NERC decision. However, no ISO or RTO should have the authority to independently reconsider any of NERC's decisions. If an ISO or RTO is the guilty party that ISO or RTO's tariff customers or consumers should not have to pay the penalties.

Fourth, both monetary and non-monetary penalties
should be considered for violation of NERC standards.

At the outset I want to 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 users, owners and operators of the bulk power system.

ISOs and RTOs are non-profit organizations that will make every effort to pass through all the costs to their market participant members. Moreover, ISOs and RTOs are unusual in that not only are the 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 ISO or RTO accountable because monetary penalties that are passed through do not have a punitive or deterrent effect on the ISOs or 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. In fact, NERC's own sanction guidelines currently recognize that the imposition of sanctions is not bounded to monetary penalties and note that they may include limitations on activities, functions or operations and placing an entity on a reliability watch list composed of major violators. These guidelines identify a variety of remedial actions that could be added to the list of sanctions for violations.

ELCON supports this approach and believes the list of available non-monetary sanctions needs to 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 officers or employees clearly culpable of the alleged violation of the reliability standards and not from the ISO or RTO as an 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, we believe 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 or RTO employees are reduced to pay the penalties.

Singling out individuals as culpable is not unique. As an example, the Nuclear Regulatory Commission has a specific list of circumstances when enforcement actions against individuals are appropriate. And the National Football League recently assessed a large penalty against one of the coaches. Although the context of these examples are somewhat different, they could construct similar treatment for officers and employees of ISOs and 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 the appropriate punishment. Those individuals who have violated reliability standards and in so doing have put a portion of the grid at risk must also pay an appropriate penalty.

My final point is that the real problem facing us today is much larger than the specific problem that is before us today. The problem before us today is how can we hold non-profit ISOs and RTOs accountable for their actions or inactions regarding NERC standards. The bigger problem is how do we hold non-profit ISOs and RTOs accountable for
ELCON has documented numerous problems with the so-called 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's no wonder to us that little real action has been taken by the ISOs and RTOs to fix the much larger problems with the markets.

I believe these will be in your laps very soon.

Thank you again for the opportunity to be before you today.

MR. LE KANG: Thank you, John.

Staff questions?

MS. KUHLEN: A number of you suggested that before any recovery could be made an individual Section 205 filing should be made. Assuming that the regional entity has already made a decision as to culpability, if you will, what do you envision would need to be shown in a 205 filing that wouldn't be covered in some blanket granting of permission to make a recovery from members or whoever.

Yes.

MR. LANDGREN: I think in our view it would be not to rehear any of the specifics, but for the RTO to demonstrate how they're going to rectify the problem and to allow stakeholders to raise concerns directly to FERC in...
1 terms of the accountability of the RTO.

2 MR. THUMM: I think I may have been the only one
3 who did not advocate a 205 filing. That's really based on
4 our position as an independent transmission company.
5
6 We enjoy forward-looking and making constructs in
7 which we do not request tariff adjustments for 205 filings.
8 We have made that argument before our Public Service
9 Commission and we feel it would be duplicitous for myself to
10 seek 205 filings for rate recovery when we don't require the
11 same of ourselves.

12 MS. BORKOWSKI: I think the VITO's recommendation
13 was really focused on kind of the due process part of things
14 because by their very nature the regional entity
15 investigations will be confidential and the only people that
16 would be involved in them would be the regional entity and
17 MISO or, as I recommended, perhaps the specific entities who
18 might have been identified as cost-causers.
19
20 Doing it through a 205 filing is the only way
21 that the other members can have say to weigh in on how the
22 result actually turned out. Otherwise you might have an
23 instance where the investigation said we don't believe the
24 assignment to individual causers is correct. Let's just go
25 ahead and assign it to everyone under Schedule 10. And
26 either there may be individual entities that have reason to
27 believe that specific cost assignment was appropriate or
perhaps might even want to weigh in that Schedule 17, which was the market rate, was more appropriate than Schedule 10. So to me it's really the only way to ensure due process for the whole field of MISO participants.

MS. LINDE: I actually didn't reference 205 in my discussion either.

The PJM transmission owners have talked about this issue but have not come to a final consensus on whether we think the 205 filing would be appropriate or needed.

I think the question boils down to where is the forum where the entity that may be asked to pay this fine has adequate due process. Those who want 205 filings feel uncomfortable that they'll get their due process rights anywhere else. And there is some uncertainty as to how this process would work going forward. Would the ERO have the non-registered agent fully involved. Would there be adequate due process.

I think it comes down to a due process question.

MR. WARREN: I would reiterate the comments of Maureen and Tamara. From a 205 perspective we do believe it will provide the ultimate due process for all involved stakeholders, including our state regulatory commissions to the extent that they needed to get involved.

As an entity with four state jurisdictions the cost recovery that we would incur through this penalty is
extremely important to us in working with our state commissions. So we believe that the 205 would allow that due process. But also it just enables all the key players to be involved in the cost allocation.

And if it's not real clear in a Schedule 10 or 17 or within an OATT or membership agreement, the 205 will clearly convey how the cost of those penalties will be assessed to each individual company.

MR. ANDERSON: We did not talk about 205 either because we don't think there should be any pass-through. It highlights to us NERC and the region's responsibility to identify the culpable parties, the guilty parties in that case.

Any party that is targeted by this process has the complete right to appeal first to the region, then to NERC, and then finally to you all. And we don't think that that process should be re-litigated. If that process, NERC and the region making the assignments and then appeals, if that does not give due process then you should fix the process. If you don't fix the process I think what you're guaranteeing is re-litigation.

MR. O'NEAL: John, I guess this question is more for you.

You say you're not in favor of pass-through. If an ISO has -- and I think if I heard you right you're in
favor of non-monetary penalties and monetary penalties for an ISO and no pass-through.

But if an ISO is dinged a fairly hefty amount of money, most if which if not all of it the RE and/or ERO assign the blame directly just to the ISO, then where does the money come from?

MR. ANDERSON: That's a good question, Keith, and we've heard of that. There is no money there. I even said non-profit ISOs and RTOs are unique because they don't have assets and they don't have this sort of money.

So I understand what you say. And I would hope - - The way we put this forth is that if there is a monetary penalty assigned first it's after -- if a monetary penalty is assigned it's after you have looked at non-monetary penalties. And secondly, since there is no pass-through, we think you ought to recognize where it is and the amount ought to represent that. But it ought to take a ding out of the salaries and bonuses of the people that are responsible because that's about the only kind of accountability that I think you can give.

From a private sector standpoint, which is where my members come from, they're subject to bankruptcy all the time and you see this all the time in the papers. I see no reason why if an ISO or an RTO -- and I'm not saying this today, none of them are even on the path to being there much
less close to it or whatever else. But if one of them is
time after time guilty of these sort of things then it is
time to start talking about decertification. One way you
can do that is to assess a penalty and they'll go into
bankruptcy and you have to have somebody else ready to take
over.

Now those are only under very unique
circumstances after an extended bit of violations.

I just say that if you rule out monetary
penalties right now, if you rule it out completely you're
going to have a much more difficult time holding a non-
profit entity with few assets really accountable. That's
really what all of this boils down to: How do you hold them
accountable? You hang over the heads, though, of the
managers that if it's really, really bad they're going to
take a hit. And it could be a significant hit. I think
you've got a lot more leverage.

MR. MUSCO: Can I ask a follow up to that?

On the previous panel they laid out some of the
ways in which compensation is linked to reliability
standards compliance. What was this panel's reaction to
some of the earlier presentations that were given by the
ISOs?

MR. LANDGREN: From my perspective what I heard
was appropriate. Some of the officer compensation should be
tied to what are deemed to be very important metrics for the organization, in this case, meaning reliability standards. My company has a similar process in place.

My biggest concern is that I don't think it should be up to this agency to dictate to an organization how they compensate their officers. It should be really up to this agency to say what the importance of meeting these standards is. Then you let the board of directors and the executive management team decide how to best reflect that into the salary structure.

And again to me, if the RTO has to appear in front of this Commission on a regular basis to try to recover those costs -- and these are voluntary organizations; sooner or later people are going to get tired of being in an organization that does that -- that to me would be natural for the board to say this is an important thing. But I don't think this agency should require it.

MR. THUMM: I heard the members of panel one this morning describe in great detail effective means of using non-monetary sanctions in dealing with reliability standards non-compliance. I do agree there is a place for non-monetary sanctions in this process.

I don't believe that the process should limit itself to only non-monetary sanctions, as I had addressed earlier. I think there's a way to craft some compromises in
MS. BORKOWSKI: If I understood correctly the speakers this morning, it sounded very similar. In my case an investor-owned utility executive, some kind of structure where you have certain goals and some overall portion of your salary or your compensation is at risk. That's carved up further into specific goals having to be met.

Overall I think all they were saying is that you could be dinged for some percentage of your salary. It certainly wasn't your entire incentive comp at risk or anything like that. That's somewhat troubling to me from the standpoint that we're not talking about a one-to-one offset of penalty to incentive comp. I don't know that that's necessarily appropriate in all cases.

The thing is I agree with Dale that this really is a board of directors issue. I think the board of directors needs to understand that it's an extremely critical issue and that to the extent that a one-to-one signal can be sent, it probably should be sent.

On the other hand, I also agree that you don't want to get things to the standpoint where the RTO can't absorb the financial penalty. And because an RTO is large by definition it's going to be tending to be in the larger category for penalty violations.

When you get to that standpoint I think there
does need to be some recognition that the RTO may constitute a different kind of being in terms of determining the amount of monetary penalty because it's never correct just to make the penalty very large, have the management unable to absorb it in some way, and to have the net result be either that it goes through assignment to people who have no culpability or results in some sort of negative financial consequence like bad credit ratings or something like that.

MS. LINDE: I agree with Dale and Maureen. It would be inappropriate for this proceeding to result in specific rules from FERC as to how executive compensation should be addressed at RTOs. It seems beyond the scope of the statutory authority.

However, there needs to be transparency in how the goals are set and how executives are being compensated. We heard different levels of transparency today from the first panel. It certainly would be appropriate for the FERC, if it did decide to rely more heavily on non-monetary penalties for NERC violations that are caused by not-for-profit RTOs, to send that message to the RTO board of directors that that is an appropriate place for the board of directors to focus its attention, and that simply because there are no monetary penalties being assessed this should not in any way suggest that these issues are not critical and should not affect the individuals directly. That may be
occurring in all RTOs and it simply may just not be transparent in all RTOs.

MR. WARREN: I would also concur with the previous panelists.

With regard to the incentive compensation you know again that should lie within the governance structure and the committee structure within the RTOs. But as I conveyed in my comments, it would be helpful to have some guidance from FERC that this is a good way to handle this approach.

I was pleased to hear that some of the RTOs have already implemented that type of compensation and the focus on reliability compliance. That's a good thing.

But in our particular company if we probably have a major violation the entire team's incentive comp for that year is probably gone. So from a weighting standpoint, if they do good in markets and they don't do so good in reliability then only 50 percent of their comp goes away.

I don't think we'd concur with that. I think it should be based on the severity of the penalty. But again, that should stay there.

But one thing we've got to remember is it's important to us at Empire that we have very talented and very capable industry professionals that run our RTO. And so we don't want to put out there any type of barriers that
would distract and make ourselves unavailable to the type of
talent that we need to implement the services that we ask
them to provide. There needs to be a balance because they
do multiple things.

But again, we want to retain and attract good
people to this part of our industry. And we want to
encourage RTOs. And so I think we need to keep that in
mind.

MR. ANDERSON: I heard basically from the first
panel that everything's fine and we don't need to do
anything; it's all under control. And I guess we have a
little bit different way of looking at it.

The real issue to me is who and how is going to
assess the penalty. Who's going to identify the culpable
entity? And to me, is it going to be the RTO or the ISO or
is it going to be the NERC and the regions?

We come down very strongly that the strong top-
down NERC and the regions process is the way that this ought
to go. We ought to leave it to them and let them make the
kinds of assignments that need to be made.

I'd like to emphasize a couple of things. One, I
said in my prepared remarks that if the penalties are passed
on to end-users under any circumstances it's the end-users
rather than the culpable parties that become the victims.
And I don't see how you get around that. If you ever are
going to pass it on you have simply passed that on. So you're struggling with how are you going to hold an non-profit organization accountable.

We think that just having hanging over their head that there could be a monetary penalty against individuals will help incent the internal kinds of processes that are absolutely needed, and we hope they're not ever used. I think it would be great.

Again, I said non-monetary is the first way to go. You could de-certify people. You can just make public the idea that things aren't being done. You can require training. There's numerous examples of non-monetary that I think would all be the things you'd come down first.

But I just don't want you to take away the idea that there isn't some sort of a penalty, potential penalty hanging over the heads of individuals that might be culpable.

MR. MORIE: I wanted to take a second to sort of explore the extremes of the pass-through question.

For example, in your opinion would there be some sort of de minimis amount below which it really wouldn't matter too much whether you got passed through a particular penalty? As an RTO or ISO member or customer, say it was $500 or something like that, that's one extreme.

The other extreme I am thinking of, for example,
let's say an ISO gets assessed -- is determined to be a violator and in response to all that it fires its CEO or takes some other really pretty drastic action, and then got assessed a penalty for the violation. Would that kind of action lead you to think, well, you know, is it worth it that they got the bad apple out of the ISO so we're willing as customers or members to sort of take a dollar hit on that type of situation?

So I ask you to explore either of those alternatives.

MR. LANDGREN: Let me just respond, as I stated before, we strongly feel that whatever financial penalty is assigned to a registered entity for a specific function should be the same for any entity, whether they're an RTO or not. So to me the size of the penalty isn't so much the issue; it's really the message.

My bigger concern -- and unfortunately I think we're seeing this in other areas -- is if you take a function, as we've heard before, many of these functions are shared jointly between the RTO and some of the other market participants. If you make it so the violation is done by a market participant, it's for profit, there's a big fine. If it's done by the RTO there isn't a fine. There's going to be more of a tendency to push upward to the ISO inappropriate functionality on the part of the market
participants.

As I've seen, we've seen this happening in Order 890 when the Commission starts talking about planning violations for planning. All of a sudden people are pushing up planning accountability that we think is inappropriate to the RTO.

So we have a real concern that if this isn't treated properly it's going to put the ISO and the RTO into a position it shouldn't be put into in terms of accountability.

MR. THUMM: The question is curious.

Certainly there would be a threshold of pain, a de minimis amount. It probably wouldn't require much thought. Certainly at the other end of the spectrum large pass-throughs have the ability to financially damage parties whether they're at fault or not.

I guess from a personal company standpoint we'd rather not pay for any non-compliances that weren't caused by us.

It was brought up moments ago that the size of MISO itself might dictate one of the larger end of the spectrum penalties. If that were to be passed on to a smaller entity -- say it was through the root cause analysis say it was possible to identify the specific contributors to an ISO non-compliance. If the ISO incurred a very large
penalty and passed that on to a very small entity that could perhaps be more damaging than any of the mechanisms we put in place to pass through such a large fine.

I think it would come down in that case to the ability to pay, certainly, if it does get passed through a rather sizeable penalty to an entity that simply cannot pay or it maybe should not pay. Mechanisms do exist to appeal those both at the NERC level and at the Commission level. I think those will have to be taken into consideration when that occurs.

If the specific question was at what point do we think that funds should be passed through, I'm not sure I have a threshold level in mind.

MS. BORKOWSKI: I really don't feel like I can comfortably say there's a threshold one way or the other.

In our comments we state that we really felt that the pass-through really ought to be the last resort. It's very important that the regional entities understand that their role in the investigation is to really get at the root causes, not just identify the fact that the violation existed but actually try to get to the point where those who caused the violation to occur can be the ones to eventually absorb the penalty.

MS. LINDE: I would turn back to the purpose of the penalty in trying to answer both of your questions. The
NERC sanction guidelines focus on key elements of their enforcement process to deter future penalties and create a certain attitude, an approach towards reliability.

As far as the threshold, whether passing a small amount through to RTO members, whether that would help achieve that purpose I'm not sure that it would. Whether it's small or it's large, I think the more important task is understanding why there was a violation and making sure it doesn't happen again and fixing the problem.

If it was the CEO who caused the problem in your scenario then the CEO's termination should help fix it. Usually it's not just the CEO; usually there's something more than that. There is some base problem. We would hope that the investigation would focus on the problem and only impose penalties for the purpose of making sure that problem gets corrected.

MR. WARREN: I would concur again, you know, regarding the incentive compensation pool.

Our thinking was, okay, well, if you've got a particular monetary amount, a fine, you first go to the pool and you would take away from that particular pool the incentive dollars for officers, department heads and professional employees. So that kind of leads to the thought of a lesser amount of financial penalty that could be imposed.
Of course the million dollars per day has got everybody's attention and we think kind of in a worst case scenario this could be millions and millions and millions of dollars. But some form of financial penalty that ties to the incentive program, you know, might be worthwhile exploring.

We have some peers within the Southwest Power Pool who do believe again that the corporate governance and the HR committees, those folks need to work on this incentive compensation.

But in terms of the potential termination of employment for directors of the board and for RTO employees, yes, that should be part of the thought process depending on the type of violation that is incurred. Again, we focus on that because if it's a repeat offense or if it's gross negligence or willful misconduct we've got a real problem there. So immediate action will need to be taken by that particular stakeholder, independent board committee, in our view.

MR. ANDERSON: I'll just say no pass-throughs. So there is no minimum.

But on the other hand you've really raised a very good point. And I wish that I had included it more in my prepared remarks. Due to time constraints I didn't.

You look at FERC's policy statement on
enforcement you'd say that the first thing to do is the seriousness of the violation. But then, starting on page ten, you give credit for internal compliance, self-reporting and cooperation. To me the firing of a CEO fits into those things very well. And your policy statement comes down and says that if enough is done internally and voluntarily there may be no penalty.

I would just simply think -- I think it's an excellent statement. And I think if you follow that and you give credit for things like internal compliance, self-reporting and cooperation -- which is what those things are -- I think you've handled it very well.

MR. DONNINI: A number of the transmission owners supported the direct assignment approach. I view that as really sort of an implementation or a formula because the filing would come in after the fact so the entity has already -- which is the target of the pass-through -- has already failed to perform in some respect that led the RTO to incur the penalty.

To what extent are the tariffs or the operating agreements clear in terms of the responsibility of various entities for performing various acts in order to ensure compliance with the reliability standards, and to what extent are the tariffs and operating agreements clear? Or would you need additional specificity in order to address
the responsibility for penalties?
I think I heard Tamara address this for PJM that there had been some efforts to create some matrices to clarify the various operational responsibilities. And now there is an effort to try and address the penalty responsibility to provide that advanced notice.

How about the other transmission owners? To what extent have efforts been made to clarify this, if needed, or are the agreements already clear?

We don't have anyone from California here. Cal ISO had raised in the last panel that they worked to try and create new mechanisms, agreements, to address the new standards.

MR. LANDGREN: I can't address -- In general certainly from ATC's perspective we have filed for some of the same functions MISO has. We have to work through who's going to be accountable for each in terms of planning authority and the like. We worked through that with the regional entities and then we put together a finding with the regional entities. So we weighted out whether or not that takes the form of a legal agreement or not. I can't really weigh in on that. I'm not a lawyer.

We have worked through within our case MISO and our regional entities what we think is a clear specification of the split in obligations between the two parties.
MR. THUMM: We at ITC in both of our operating companies ITC Transmission and Michigan Electric Transmission have registered with the region for performing functions associated with reliability functions. We are transmission owners, transmission operators and transmission planners. Together we, with some of the larger loads and entities within Michigan, we've registered generally as a balancing authority.

The Midwest ISO, on the other hand, has assumed the reliability functions and the reliability coordinator planning authority and transmission service provider. There is no apportionment or allocation of responsibilities between the parties other than those that are inherent in those functions which we've all registered for.

We've subscribed to a certain set of responsibilities within the standards. Those are well enumerated. So is the Midwest ISO and so is our balancing function in terms of who does what and who's responsible for what. We're each responsible for our own functions. We each have requirements associated with each of those functions. And then we all are expected to bear the costs of any non-compliances.

There are no formal processes in place within the Midwest ISO that describe how these penalties can get allocated amongst the members. Indeed, that's why we're
here today is because of the filing that was made to suggest how we could do that in the future.

MS. BORKOWSKI: I think I'm interpreting your question a little bit differently.

If I understand what you're saying, certainly as Brian and Dale described, to the extent that there are standards that have specific functional entities labeled as this is a balancing authority standard or this is a planning authority that has responsibility here, those are well delineated within MISO. But I think the problem comes in in the example I gave about the cost causer or the penalty causer.

For example, if 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, 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
But on the other hand, the very reason that the standard may be being violated -- the other thing, to make it even further complex in terms of how does that relate to the tariff, within the tariff, as MISO has just filed it last week, there are tolerances for generator performance who are, for example, providing the regulation service role. And as long as they're operating within certain bandwidths they're considered in compliance with the tariff.

But if all the generators that were providing regulation service were within the bandwidth but all deviating on the same side, they may ultimately cause non-compliance with the standard. So here you have an instance where they're complying based on what the tariff says is required, but in combination it resulted in non-compliance with the standard, which is again part of the reason we feel that the regional entity investigation needs to be done in sufficient detail to identify who those cost causers were and the Section 205 filing needs to be made so all of this evidence can be brought to bear because it's not necessarily captured in the tariff.

The tariff only addresses that piece of the generator deviation that made a difference in the market cost. It doesn't address what any kind of penalty impact
MS. LINDE: I did discuss the matrix and the various documents that PJM does have in place. And the transmission owners and PJM do feel very confident that we know what we're responsible for and what PJM is responsible for, even at the sub-level beyond just what we're registered for.

I think Maureen makes a very important point, though, that just having that responsibility determined in advance doesn't negate in any way the need to have the full review. If there is a violation it will be a factual question that needs to be examined as to what went wrong, why did it go wrong. And there are going to be various opinions as to who caused the problem.

We believe it's important to include the right parties in that ERO investigation and not just limit it to the registered agent. But recognize that there are other parties within our TO -- not that they need to be registered agents. We think we have the right mixture of who the registered agents are.

But there are supporting parties that need to be part of that factual investigation to make sure we have a complete picture of what happened. That needs to be done through a joinder process or some other process so it can be done on a confidential basis.
MR. WARREN: Michael, in working with the other balancing authorities within the Southwest Power Pool and the SPP through the balancing authority agreement, whenever the SPP started up their EIS energy imbalances services market, we identified in our agreement the need to address financial penalties and the resultant WEIS market -- and we kind of left it general.

There's work to be done. We believed at that time that the tariff did not adequately address, nor did the membership agreement or bylaws address, the recovery of penalties that would be assessed to us caused by the SPP RTO. So we think there's some work to do with regard to the tariff or membership agreement or bylaws.

But clearly we were working through that whenever the Commission came out with the need to have this technical conference.

MR. ANDERSON: I think Maureen gave an excellent example of how an entity might be responsible that is not registered or initially not found guilty or culpable. That's a problem that's going to be before us; there's no doubt about it.

I go back to the process, though. At least theoretically the regions and NERC will determine who is responsible for whatever the violations are. If they determine in this case MISO is responsible but MISO doesn't
think it is MISO can appeal. That's in the process already. So MISO appeals. And it goes through the region and then to NERC and then ultimately to FERC.

As far as I'm concerned, if that process is working the way it's supposed to be working -- which I think it is -- that should take care of the problem. If MISO isn't the responsible one and they say that it isn't the responsible one in the appeal, the responsible party is included, and that's the way it goes.

I think it's important for us to remember that we're early in the process. We've got a lot of learning to do. There are going to be some bumps as we try to work our way through these initial problems.

But I think if you focus on the process the way the process has been established, I think it's a good process. And I think it will handle it. It's just going to take a little bit if time and there will be some appeals.

MR. LE KANG: Thanks, folks.

I'd like to move on to our third panel right now. We'll try to stay within our time frame. I doubt if that will happen.

(Pause.)

MR. LE KANG: Let's start up the third panel. The third panel consists of NERC acting as the ERO. And we have four regional entity members here.
I'm sure this is included already in your comments. But if it's not, if you could address at least one of the items I heard on the first two panels is the extent of the investigation and whether or not an investigation by the ERO and the RE will get to a root cause investigation or not, I'd appreciate it. Thank you.

Dave, you're going to start.

MR. WHITELEY: Thank you.

Good afternoon. My name is David Whiteley, NERC's executive Vice President. I will speak to you this afternoon on behalf of NERC as the electric reliability organization.

I appreciate the opportunity to participate in today's technical conference to explore issues associated with cost recovery of penalties for reliability standard violations assessed against independent system operators and regional transmission organizations in the United States.

One of the primary activities undertaken by NERC in its role as the electric reliability organization is to enforce Commission approved reliability standards for the bulk power system. Compliance with approved standards is expected from all users, owners, and operators that have a material impact on the bulk power system. These users, owners and operators are identified in NERC's compliance registry.
Material to this technical conference is the fact that all ISOs and RTOs in the United States are included in the NERC compliance registry and are held accountable to compliance with reliability standards. If a violation of a standard is confirmed, a financial penalty could be levied against an ISO or RTO just as any other registered entity.

NERC has also established Commission approved delegation agreements with eight regional entities to conduct compliance audits and investigations of possible standards violations. Again, focusing on the subject of today's conference, NRC and the regional entities work together to determine whether a financial penalty for an ISO or RTO is appropriate.

However, NRC and the regional entities do not have an interest in how the ISO or RTO funds or recover those penalties. NERC's interest and the reliability entity's interest is to improve reliability.

The second notice for this conference contains several questions and topics for this panel to address. I will speak to each of them briefly. I believe as Mr. LeKang has asked, these comments do include some specificity on the topic that he mentioned. If not, I'll certainly ask and will address them at the end of the presentations. I'll also include a discussion of how joint registration organizations may fit into this topic because an ISO or RTO
could also serve as a JRO for its members.

I apologize for the alphabet soup.

The first question for the panel to address deals with compliance registration. The compliance registry criteria are written to ensure there are no gaps in coverage for compliance with reliability standards. If an entity performs functions that are material to the reliability of the bulk power system the entity will be included in the compliance registry.

With respect to the application of penalties, the only provision that exists today that may prevent a user, owner, or operator from being penalized is that another entity has registered to take on its responsibilities under the JRO provisions of the NERC registration criteria. Under these provisions a user, owner or operator may transfer compliance responsibility to a JRO through an acceptable agreement.

NERC would continue to identify the entity that actually violated a reliability standard and assess the penalty to the JRO. NERC monitors compliance with approved reliability standards and does not monitor compliance or failure to perform under tariffs or other agreements.

On the issue of pass-through of penalty costs, as stated earlier, NERC and the regional entities do not influence nor become concerned with how the penalty is
collected with an ISO or RTO. If the ISO or RTO serves as a joint registration organization for certain functions, NERC will recognize the user, owner or operator that actually violated the standard and assess the penalty to the ISO or RTO acting as the joint registration organization.

NERC or the regional entity will only impose penalties for violations of reliability standards by users, owners and operators listed in the compliance registry. However, compliance investigations will take place regardless of affiliation with an ISO, RTO or JRO. Depending on the outcome of such investigations, individual members of an ISO, RTO or JRO may be named as having violated applicable reliability standards. Each entity named will be expected to prepare and implement a mitigation plan to correct deficiencies in its performance that led to the violation.

If, as part of the investigation, NERC or a regional entity determines that an entity not currently included in the compliance registry should be added to the registry, action will be taken to include that entity in the registry.

Organizations that are members of an ISO or RTO are not granted exemptions from compliance to reliability standards. Quite to the contrary, they must comply at all times with applicable standards. The same is true for
entities under an agreement with a JRO.

In the case of a joint registration organization, the JRO has agreed to act as the primary point of contact for organizations on whose behalf it has registered. The JRO will receive notices of violations of reliability standards, will be responsible for collecting and submitting mitigation plans from organizations it represents, and will be held responsible for paying any fines associated with non-compliance of an organization it represents.

It's important to recognize that compliance investigations and the assessment of penalties are separate matters. Where violations are confirmed, sanctioning will be determined by the regional entity or NERC separately and independently for each registered entity that is a party to a violation or common incident that produces or results in violations.

NERC's October 18th, 2006 compliance filing on non-governance issues addresses this point in item number 72.

In dealing with a situation where an ISO or RTO and one or more of its members violate reliability standards, the specific circumstances of each case would be considered in the application of penalties. For example, if one member of an ISO or RTO violated a single standard those circumstances would be considered. However, if an ISO or
RTO and several of its members violated a standard the violation would be more pervasive and would be considered in the application of a penalty.

Mitigation plans would be required from all users, owners, and operators who violated the reliability standard. In cases in which multiple members of a JRO simultaneously violated the same reliability standard requirements for the same event, the JRO would be assessed a single penalty for the violation.

It is NERC's intention that all parties violating reliability standards will be identified. NERC or the regional entity will conduct compliance investigations, require mitigation plans, and assess appropriate penalties for any user, owner, or operator that violates a reliability standard.

With regard to entities that did not violate a reliability standard but may have contributed to another's violation, there is no way to quantify the degree of such a contribution. Either a user, owner, or operator violated a reliability standard or it did not. This is true for ISOs and RTOs and the case in which a joint registration organization has registered on behalf of a group of users, owners, and operators.

NERC and the regional entities will investigate the root cause of a violation and extend that investigation.
to entities not on the compliance 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 this case the entity must also submit a mitigation plan to the regional entity and NERC to resolve the violation.

As part of the case record the inquiry will also address the reasons and history regarding why the entity was not originally included in the compliance registry.

Thank you again for the opportunity to participate in this technical conference. I look forward to your questions.

MR. LE KANG: Thank you.

Ray.

MR. PALMIERI: Good afternoon. Thank you for this opportunity to present the views of ReliabilityFirst Corporation on the cost recovery of penalties against ISOs and RTOs. My name is Ray Palmieri and I am the Vice President and Director of Compliance for ReliabilityFirst. ReliabilityFirst is one of the eight regional entities deforming key delegated functions in support of the ERO. We operate in 13 states and the District of Columbia, and are governed by a hybrid board comprised of both stakeholder and independent directors.
Our footprint is comprised almost entirely of two large RTOs with fully developed electricity markets: the Midwest ISO and the PJM RTO.

Key among the delegated functions ReliabilityFirst performs in support of the ERO is the identification and registration of all users, owners and operators the bulk power system in our footprint. We have diligently carried out this activity using the registration criteria developed by NERC and accepted by the Commission.

This criterion establishes the basis for registration taking into account the entities' material impact to reliability. The registration criterion also permits users, owners, and operators to elect to register jointly via a joint registration organization, or JRO, as Dave has described.

There are currently seven JROs registered in ReliabilityFirst with 44 members under them. MISO and PJM are not registered as JROs. If these RTOs decided to register as a JR there would have to be mutually accepted agreements developed with their members to address the responsibilities and accountabilities of each entity.

ReliabilityFirst fully supports the comments made Dave and intends to treat compliance assessment and penalties for RTOs, ISOs, and JROs and their members exactly as stated by him. I would like to stress a few points,
however.

Although this technical conference is centered on RTOs and ISOs, we believe it is important to recognize that the application of penalties extends beyond RTOs and ISOs, specifically the JROs registered in each region. Municipals, cooperatives and independently owned power plants can also register as JROs and they ill face the same issues the RTOs and ISOs have brought forward when dealing with penalties assessed for violations of reliability standards. It is ReliabilityFirst's intention to treat all JROs, RTOs, and ISOs uniformly.

RTOs are very important members and stakeholders of our organization. But we consider all of our members and stakeholders as equally important. The JROs would be managed in a similar manner.

We take no position on how RTOs, ISOs or JROs and their members allocate penalties associated to them for violations of reliability standards. This should be negotiated by the parties and specified in their individual agreements.

Our interest is in identifying and correcting deficiencies associated with transmission reliability in the most expedient manner possible. We will work with and through the RTOs and JROs to ensure that their members correct such deficiencies when they are discovered.
If an entity not registered with the region is involved in an event that contributes to a violation by the RTO, ISO or JRO, that entity will need to be assessed as to their requirement to be registered as a user, owner, or operator of the bulk power system. They will be included in the regional review and assessment of the violation and, if appropriate, would be expected to submit a mitigation plan to correct the deficiencies identified. They would be advised of their registration by the region, and be held accountable with penalty liability going forward as a registered entity.

Regional entities cannot delegate our compliance activities to third parties. We are obligated to carry out both the compliance assessments and the levying of penalties and sanctions against the registered entities as they pertain to their registered functions. We must do so independently, fairly, and uniformly.

I'd like to thank you for the opportunity to speak before the Commission Staff and look forward to answering any of your questions.

MR. LE KANG: Thank you, Ray.

Go ahead, Larry.

MR. GRIMM: Thank you, and good afternoon. My name is Larry Grimm, the Acting Chief Compliance Officer for the Texas Regional Entity. I appreciate the opportunity to
participate in this conference today.

The Texas Regional Entity is an independent division of the Electric Reliability Council of Texas. The Texas RE is the organization established to develop and enforce reliability standards within the ERCOT region. The ERCOT Region is the geographic area and associated transmission and distribution facilities that are not synchronously connected with electric utilities operating outside the jurisdiction of the Public Utility Commission of Texas. The ERCOT geographic region includes 200,000 square miles, 85 percent of Texas load, and 75 percent of Texas land area.

The Texas RE fully supports the comments made by Mr. Whiteley and intends to treat compliance assessment and penalties of ISOs, RTOs or JROs and their members exactly as stated by him, and as provided in the NERC rules and the Texas RE and NERC amended and restated delegation agreement. The Texas RE takes no position on how ISOs, RTOs or JROs and their members allocate financial penalties assigned to them for violations of reliability standards. In this context Texas RE's interests are:

First, that the entity or entities responsible for the tasks and functions in the NERC model and who are material to the reliable operation of the interconnected bulk power system are properly registered.
Second, that the applicable reliability tasks and functions are performed and the NERC reliability standards, and any Texas RE reliability standards that may be promulgated, are met.

Third, that the Texas RE's ability to enforce the applicable reliability standards against the appropriate entities is clear.

The agreements among ISOs, RTOs or JROs and their members as to who will be responsible for meeting the reliability standards and therefore will be registered and subject to the appropriate financial penalties is between the parties involved and codified in their agreements.

Our goal with respect to every failure to meet reliability standards is to identify and correct deficiencies in the most effective manner possible. We will work with all entities subject to the reliability standards to ensure that deficiencies are corrected when they arise.

Thank you again for this opportunity to appear before you. I look forward to answering any questions you may have.

MR. LE KANG: Thank you, Larry.

Ed, go ahead.

MR. SCHWERDT: Good afternoon to all of you. My name is Ed Schwerdt. I am President and CEO of NPCC, the cross-border regional entity and criteria services
corporation for northeastern North America.

NPCC's international footprint includes the state of New York, the six New England states and the Canadian provinces of Ontario, Quebec, New Brunswick, and Nova Scotia. As one of the eight FERC-approved regional entities, NPCC appreciates the invitation to provide comments to the Commission Staff on issues associated with cost recovery of penalties assessed against ISOs and RTOs for any violation of reliability standards.

My remarks today will be limited to the US portion of NPCC, that portion served by the New York Independent System Operator and ISO-New England, respectively.

Let me begin this presentation by stating that NPCC endorses and fully supports the statements previously made by David Whiteley on behalf of NERC. NERC and all of the regional entities are committed to working closely together to achieve fair, objective, and consistent enforcement of FERC-approved reliability standards.

Towards that end, NPCC utilizes the NERC registration guidelines, as well as Sections 501 and 507 of the NERC Rules of Procedure dealing specifically with joint registration organizations as the guidelines to determine which entities should be included in the compliance registry.
Actually, in response to a question to the panel from the Commission Staff, there are no provisions within those documents that prevent any entity from registering for compliance to the NERC reliability standards.

NPCC has emphasized to the users, owners and operators of the bulk power system in the northeast that a fundamental element of an effective compliance monitoring and enforcement program is unambiguous registration. Clear written identification at the outset of the division of responsibilities for reliability standards, on a requirement by requirement basis if necessary, forms the basis for any division of responsibilities regarding compliance violations and serves as a factor in the determination of any potential assessment of penalties later on.

Through clearly defined terms in written agreements the requirements that each entity is responsible for meeting are defined. Similarly, potential penalties assessed for violations to those requirements would be evaluated consistent with the terms of such agreements.

Both the New York ISO and ISO-New England are registered within NPCC for some seven functions each, including registration as reliability coordinators, balancing authorities, transmission operators, transmission service providers, planning coordinators, transmission planners, and resource planners. Within those functions
there are currently some 68 applicable standards approved by the Commission with some 593 identified requirements. NPCC monitors compliance with those requirements through numerous methods, including self-certification, self-reports, compliance audits, spot checks, event investigations and complaints.

With respect to the Commission's questions regarding the pass-through to its members of penalty costs associated with violations of reliability standards for which an ISO or RTO has registered, there is no mechanism within the NERC Rules of Procedure that would allow such a process.

In addition, such a separate after-the-fact determination by an ISO/RTO of an individual entity's culpability would effectively establish another level of compliance enforcement and create uncertainty with regard to the enforcement authority granted to NERC and delegated to the regional entities by FERC. The determination of violations of reliability standards through a thorough process of investigation of all entities potentially contributing to a violation is the responsibility of the regional entities and of the ERO.

Within NPCC each registered entity, whether they are an ISO/RTO or market participant, is responsible for meeting those reliability standards that are applicable to
the functions for which they have registered.

As per the NERC registration guidelines, NPCC does not monitor nor will it hold those not in the registry responsible for compliance with the standards. However, an entity which is not initially placed on the registry but which is identified either through an investigation or other means as having a material reliability impact will subsequently be added to the registry.

Thank you for the ability to address these issues. I'm happy to address any comments and questions from the Commission Staff.

Thank you.

MR. LE KANG: Thank you, Ed.

Dan, why don't you finish up.

MR. SKAAR: Thank you, Don.

Good afternoon. I appreciate the opportunity of being here at today's technical conference. My name is Dan Skaar, President of the Midwest Reliability Organization. My comments will be limited to the United States.

The Midwest Reliability Organization is a cross-border regional entity with an approved delegation agreement. Our geography includes eight states in the upper Midwest in North America and the provinces of Manitoba and Saskatchewan. The region includes a significant amount of public power and much of the transmission system is not
under a regional transmission organization tariff. And

nearly all the region is composed of non-retail access
jurisdictions.

However, the MRO does have both a structured
market -- the Midwest ISO market -- and bilateral markets.
MRO supports NERC and also certainly supports the statements
made by David Whiteley of NERC in registering all those who
are owners, users and operators of the bulk power system
using the established registration criteria. We have over
120 registered entities and over 400 various functions,
including two reliability coordinators -- the Midwest ISO
and Saskatchewan Power, the latter of which is in the
process of finalizing its role as a reliability coordinator.
In addition we have seven joint registration organizations.

Our understanding is that NERC, the regional
tentities with approved delegation authority, and the
Commission have the responsibility to determine violations,
culpability and the appropriate penalties resulting from
violations without undue preferences. We collectively have
worked very hard to establish the right structure, fair
rules, and the necessary due processes to carry out our
responsibilities to those entities subject to standards,
regardless of their corporate structure of tax status,
consistent with the intent of the legislation.

After the panel discussions I had a couple of
concluding thoughts and concerns. It seems to me that we're trying to address two questions. One is applicability of the financial penalties in the US. We took the position that monetary penalties applied to everyone under the legislation. The other issue, collection of financial penalties, it seems to me that this is a business issue for those subject to reliability standards. Business practices may need to be revised to accommodate the new reality and risks of mandatory standards. Again, regardless of your past budget habits or tax status.

I do have a concern that we need to avoid placing any registered entity in double jeopardy or duplicate proceedings regarding the same violation at a time when we need more investments in the grid.

Thank you.

MR. LE KANG: Thank you, Dan.

MR. O'NEAL: Let me maybe address this first question to David, if I could, with NERC.

I just want to understand. What I heard I think several of the speakers -- but you in particular -- with regard to registration -- maybe I'll just use the example that was brought up in the earlier panel.

Under an ISO several of them, if not all of them, are registered as balancing authorities. Within that region generators would not be registered, I think, as balancing
authorities. So given that -- and we have a violation of
one of the balancing standards and it's obviously assigned
to the ISO in terms of money, but there are other people
culpable that have done something wrong -- principally maybe
the generators -- I think I heard you say that in the
investigation that NERC and/or the REs would conduct they
would actually look at those entities and determine if
indeed they were causing the violation. Is that true?

MR. WHITELEY: Let me start by saying that the
intent of the investigation would be to find out all the
facts and circumstances surrounding the violation. And from
that standpoint as information becomes known to the regional
tentity or to NERC as the investigation unfolds, that
information is going to be added in to what we know about
what happened, what occurred.

The point that I would make is when you talk
about compliance against a reliability standard -- in the
example that you've given if the generator isn't performing
balancing authority functions there's nothing for us to
compare against -- it can be a contributing factor. In
other words, it's part of the fact pattern. But in terms of
the violation on the particular standard it's only the ISO
that signed up in your example. I kind of liken this to --
and there was an earlier example about the football
situation. I'm sure the football commissioner took no joy
in issuing those monetary penalties. But it's the duty he
signed up for, that in those situations he had to do it.

            In this case the balancing authority is the ISO
in your example. It's the duty they signed up for and the
agreements they have with the generators that provide that
service. We need to take into account what happens when the
generators don't perform. The information would be known
but the only thing we have to compare against is the
reliability standards.

            MR. O'NEAL: As a follow-up to that, we've heard
a lot today of people favoring fingering or identifying the
culpable parties for a reliability standard violation. In
the example that we're talking about the ISO may not be the
party responsible for the violation, although if they're the
balancing authority they're the registered entity for that.
It may well be the generators.

            If I'm hearing you correctly, you're not really
going to be able to pinpoint anything that would give this
Commission or anybody assurance that somebody is 'x' percent
responsible for this violation. So in other words, the
penalty dollars -- which I know you're not involved in --
but if you don't as the investigator identify the percent
that each party is guilty by, then the penalty can't be
assigned directly to those entities.

            MR. WHITELEY: Again, I would say our role is to
compare against the standards. And the violating entity in this case would be the ISO as the balancing authority. The facts of how that violation occurred would certainly be known. But it's not our role to determine that generator 'x' was so many percent, generator 'y' was some other percentage. The violation is against the standard and the entity that signed up for that responsibility.

MR. HEGERLE: David, the ER would know about it. But would that be part of the documentation that goes with it?

MR. WHITELEY: Yes. Obviously, the whole investigation record would contain all the information that's uncovered. Maybe what's at issue here is how deep do you go: all the way to ultimate root causes of why a generator did or didn't fulfill its responsibility to the ISO?

Those are going to be fact-specific cases and I don't think that there's any way that we can determine that up front. When they occur we're going to have to do the investigation, put the information into that record, the investigation record, and proceed forward. I don't know that there's any way we can determine now exactly how deep you have to go in all situations.

MR. HEGERLE: Well, you review your report as being sufficient for the RTO or ISO to allocate penalties
on. I know it's not your job, but they all sat before us and said, 'You guys ought to do that; we shouldn't do it, you should do it.'

You think that record would be sufficient to work from?

MR. WHITLEY: I think the record will be sufficient to work from, but I don't think it's the role of the ERO to figure out that distribution of contribution.

MR. O'NEAL: Just to follow up, taking the same example, would you then, if the generators are not registered as a balancing authority function, would you then say afterwards -- would you take some measures to maybe say they should be registered? I think I heard you say that might be the case.

MR. WHITLEY: If indeed they're performing functions that are balancing authority functions then, yes, we would seek to put them onto the registry as balancing authorities. If they're not performing those functions but they have a contract to some other group -- in this case an ISO that is a balancing authority -- there'd be no need to put them on the registry because they're not performing those functions.

But if indeed the investigation finds that, whether they're on the compliance registry in a different area or not, they'd be put onto the compliance registry
going forward.

MR. FIRST: Just to follow through with the example of the generators, if the ISO or RTO were being investigated formally now by a regional entity what opportunity would generators have to participate in this formal investigation proceeding?

I'm not sure if that's a question just for NERC or for each of the regional entities present.

MR. WHITELEY: Not intending to dodge this, but since the investigation starts with the regional entities perhaps we should start there as opposed to with NERC's role.

MR. PALMIERI: During the investigation we believe that the organization, the ISO, the RTO, would in fact in their root cause evaluation would have identified the generators that may have had an impact on that particular violation. I believe that they would identify that also to the regions.

And then our obligation would be to assure that there were no other violations that may have occurred on the part of the generators. We would need to look not specific to the BA, but there may have been other things that were problems for the generators. And we would need to assess that.

If the ISO or RTO organization, or JRO, were to
proceed with a challenge or a hearing or appeal with a particular violation there are rules within the NERC guidelines as to whether or not we would include an additional party to be considered during an appeal of a violation to the ISO or RTO.

MR. GRIMM: We, too, would receive a report from a ISO that indicates and reviews the incident. And we would evaluate that report and would certainly expect once the compliance investigation is complete, violations are identified, we would expect a complete and detailed mitigation plan that would address the issue and hopefully prevent it from happening again.

MR. SCHWERDT: MPCC would also do a thorough investigation should there be indications that there are culpable entities non-registered, in addition to the ISO, that had caused the failure of the standard.

But before we go too far with this example, let us not collectively give the Staff the impression that the way to solve this would be to have an expansion of BAs registered. The balancing authority function is something very, very specific. Its roots are in the control area function. And it's specifically to take a specific group of generators -- here we're talking about generators under an ISO -- and to, within a prescribed area, hold that prescribed area to very specific electrical requirements.
The BA function is in itself supposed to be able to accommodate the non-performance of any single generator. If in fact there are generators that are non-performing, as Ray said, are they non-performing either with NERC reliability standards associated with generator owners or generator operators or, in the case of an ISO, are they non-performing versus a market rule, which is not something that we would look to to monitor compliance with.

Our responsibility as regional entities has to do with the reliability characteristics of the balancing authority. And I don't want to give the impression that we as an industry would be better served by having smaller and smaller balancing authorities. Actually it's been the position of NPCC for a long time -- and, I would believe, panel one -- that the larger the balancing authority to a certain extent the better because there is diversity and adversity. And you can adjust the system, the larger the footprint that you have.

MR. SKAAR: I think your question may have been -- maybe if I restate it.

The ability of a generator to be involved in an investigation or in a finding -- and I think it could be dependent on whether it's event-related, for example. And I guess from our perspective we would look at all of the standards and applicable requirements and we would consider
all of those separate investigations. And then perhaps
later we could consolidate it into one. But I think
initially it would be separate.

We would talk to each individual violating party
or potential violating party.

MR. FIRST: Just to clarify a little bit. What I
was hearing from the second panel is that an entity in a
position of that type of generator is concerned that the ISO
might get assessed a penalty. And the ISOs are going to
want to turn around and directly pass through the cost of
that penalty to the generator that they perceive as being
the underlying cause of the reliability standard violation.
So the entities on panel two wanted to know what sort of
opportunity they'd have to participate in those formal
proceedings where the ISO may get assessed a penalty but may
or may not actively represent the positions of those
generators.

MR. HEGERLE: The twist I saw with what you're
saying is that the generators, for example, aren't
violators. They're causers, we've been calling them. How
would they get the chance to speak, because you look at what
they did and say, 'You didn't violate a standard; the BA
violated the standard.' So will they ever get an entrance
into the room or not; that's, I think, your question.

MR. WHITELEY: I'll just summarize by saying that
in the investigation the fact pattern is going to matter. And those that are involved in the fact pattern obviously have to be able to participate to the extent that their facts are material to the investigation.

Again, to the point of is it the regional entity's role or ERO's role to determine splits of culpability, I think not in terms of compliance against the standards. It's pretty clear based on the registry as to who's complying with what.

MR. MORIE: I have another question in the same general area.

Suppose there is a situation where a standard is violated and the entity that seems to be the most directly related to this violation says, 'Well, actually it wasn't us that caused it; it was somebody else, 'x..' But 'x' is not any kind -- it's not on the registry in any capacity.

You folks from the REs are going to be the first lines in doing these investigations. You go to try to talk to this entity 'x' but it says, 'Well, we respectfully decline to say anything to you because we're not registered.'

Have you given any thought to that possibility happening and what you might do in that situation considering that presumably 'x's' information would be really important to compiling a complete record in the
investigation or the analysis?

MR. WHITELEY: Let me just lead off by saying that yes, we've talked about that. And there's a couple of points to keep in mind.

The first thing is that there are 1500-plus entities in the registry already. So the fact that we're unable to talk to one entity that's not in the registry, we're still going to be able to collect an awful lot of facts around the situation by talking to those that are on the registry, and fully intend that if those facts indicate that someone or some entity needs to be placed on the registry we'll do so on a going-forward basis. And, of course, then there's rules for challenging being placed on the registry after notification.

But beyond that, I think that the other point to be made is that if indeed an entity would respectfully decline to talk to us because they're not on the registry at the present time, even though we're going to put them on the registry going forward, then it's going to come back to the backstop authorities at the Commission here to investigate and get good data from whatever the entity is.

I would full expect that entities would want to comply with the Federal Regulatory Commission's authorities and purview in seeking to get data on an incident that's critical to reliability. So hopefully that wouldn't be the
issue. But if it is, I believe that there's ways that that will be taken care of.

MR. SCHWERDT: Roger, if I could jump in.

I think what you've heard now in the three panels is a desire for a single place to conduct a thorough and complete investigation to bring before the Commission, a full set of facts and circumstances, all the contributing issues associated with a compliance violation. What you're hearing from panel three, NERC and all the EROs is that we are stepping up to the plate. We will be the place to do the investigation. That is not a role that the regional entities nor NERC are expecting the ISO or RTOs to do. It is a role that the members of the ISO, RTOs want done, and the regional entities have specifically, in the delegation agreement, signed on to do that and produce a complete record so the Commission can have all of the facts associated with any violation before it.

MR. LE KANG: It looks like we're done.

I'd like to thank you folks for spending your time with us today.

(Whereupon, at 1:15 p.m., the technical conference in the above-entitled matter was adjourned.)