

127 FERC ¶ 61,196
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Sudeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

New York Independent System Operator, Inc.

Docket No. ER09-945-000

ORDER ACCEPTING TARIFF REVISIONS

(Issued May 29, 2009)

1. On April 1, 2009, under section 205 of the Federal Power Act (FPA)¹ and Part 35 of the Commission's regulations,² the New York Independent System Operator, Inc. (NYISO) submitted proposed revisions to its Market Administration and Control Areas Services Tariff (Services Tariff) and Open Access Transmission Tariff (OATT) and a new Rate Schedule 11 to its OATT. The proposed revisions would allow NYISO to seek Commission approval for recovery of penalties assessed by the Commission, the North American Electric Reliability Corporation (NERC) and its Regional Entities, or by other government authorities. NYISO states that the purpose of the proposal is to create a method for allocation of penalties regarding violations of NERC Reliability Standards as well as other regulatory requirements. As discussed below, the Commission accepts the proposed tariff revisions, effective June 1, 2009, as requested.

I. Background

2. Section 1211 of the Energy Policy Act of 2005 (EPAct 2005)³ added section 215 to the FPA, which provides for the development and enforcement of mandatory reliability standards by an electric reliability organization (ERO) to be certified by the Commission.

¹ 16 U.S.C. § 824d (2006).

² 18 C.F.R. Part 35 (2008).

³ 16 U.S.C. § 824o (2006).

The ERO may impose penalties for violations of reliability standards, subject to Commission approval.⁴ On July 20, 2006, the Commission certified NERC as the ERO.⁵

3. Order Nos. 672 and 672-A⁶ implemented the requirements of EPAct 2005 regarding the selection, standard-setting procedures, and operational aspects of the ERO. In these orders, the Commission denied requests to (1) exempt non-profit regional transmission operators (RTO) and independent system operators (ISO) from monetary penalties for violations of the reliability standards, or (2) authorize RTOs and ISOs to recover such monetary penalties from their customers on an automatic basis. Rather, the Commission stated that it would consider proposals to recover the costs of any such penalties imposed on RTOs and ISOs under section 205 of the FPA on a case-by-case basis.⁷

4. Each NERC-developed, Commission-approved reliability standard includes an “applicability” section that identifies the types of Registered Entities that must comply with the standard based on the NERC functional model. All RTOs and ISOs have registered as transmission service providers under the NERC functional model, and have registered for other functions as appropriate. Under section 215(e) of the FPA, an RTO or ISO that fails to comply with the requirements of the applicable reliability standards may be assessed a penalty by the ERO, its Regional Entities,⁸ or the Commission. Each Regional Entity has a Compliance Monitoring and Enforcement Program with which to monitor, assess, and enforce compliance with reliability standards. Each Regional Entity’s program is based on NERC’s *pro forma* Compliance Monitoring and

⁴ The Commission, on its own motion, may also investigate violations of the reliability standards and impose penalties. 16 U.S.C. § 824o(e)(3) (2006).

⁵ *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062, *order on reh’g*, 117 FERC ¶ 61,126 (2006).

⁶ *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204, at P 634-35, *order on reh’g*, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006).

⁷ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 634-35; Order No. 672-A at P 55-58.

⁸ A Regional Entity is an entity delegated by the ERO to have enforcement authority on Commission-approved Reliability Standards, pursuant to Order No. 672. *See* 18 C.F.R. § 39.8 (2008).

Enforcement Program, and is set out in Exhibit D of the Regional Entity's delegation agreement with NERC.⁹

5. In Order No. 693, the Commission stated that it is important to have as much certainty and stability as possible regarding which users, owners, and operators of the bulk power system must comply with which reliability standards. NERC, as the ERO, has developed its compliance registry process to accomplish this goal. The Commission noted that it has held that NERC's compliance registry process is a reasonable means "to ensure that the proper entities are registered and that each knows which Commission-approved reliability standard(s) are applicable to it."¹⁰ The Commission stated that it will not assess penalties against an entity that has not previously been put on notice, through the NERC registration process, that it must comply with particular reliability standards. Under this process, if NERC later discovers that an unregistered entity should have been subject to a reliability standard, NERC may add the entity, and possibly other entities of a similar class, to the registration list and direct future corrective action.¹¹ The Commission stated that it believes that this should prevent an entity from being subject to a penalty for violating a reliability standard without prior notice that it must comply with that reliability standard.

6. To further clarify how this prior notice requirement would apply within RTO/ISOs, on March 20, 2008, the Commission issued a Guidance Order¹² outlining how RTOs seeking to recover costs they incur for reliability penalties assessed under section 215 of the FPA could provide notice of such potential recovery in their tariffs or contracts. In the Guidance Order, the Commission acknowledged the careful balance required when addressing recovery of reliability penalties by RTOs and ISOs. The Commission noted that, as the facilitators and managers of the nation's largest and most complex energy markets, RTOs and ISOs are essential to maintaining the reliability of

⁹ See, e.g., *North American Electric Reliability Council, et al.*, 119 FERC ¶ 61,060, at P 25 (2007); *order on reh'g*, 122 FERC ¶ 61,245 (2008).

¹⁰ *Mandatory Reliability Standards for the Bulk Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242, at P 92 (quoting *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062, at P 689 (2006)), *order on reh'g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

¹¹ See NERC Rules of Procedure, § 500.

¹² *Reliability Standard Compliance and Enforcement in Regions with Regional Transmission Organizations or Independent System Operators*, 122 FERC ¶ 61,247 (2008) (Guidance Order).

the electric system. However, the Commission also noted that, because these entities are typically member-supported non-profit organizations, they do not have an independent source of funds with which to pay any penalties assessed to them by the ERO. The Commission stated that granting blanket authority to pass through monetary penalties to their customers automatically, however, could significantly reduce the incentives for RTOs and ISOs to maintain strict compliance with reliability standards. As a result, the Commission concluded that it would only accept penalty recovery mechanisms under which the Commission could review the appropriateness of each penalty pass-through on a case-by-case basis in filings under section 205 of the FPA under two alternate procedures.

7. First, in cases where the RTO or ISO deems an entity to be responsible for a violation and the RTO or ISO itself is assessed a monetary penalty, the Commission stated that it will entertain a section 205 filing by that RTO or ISO to directly assign the costs of the penalty to that other entity. However, to ensure due process to that targeted entity, the Commission stated that it will not entertain any such filing unless the targeted entity has been notified during the course of the investigation, other inquiry into, or hearing of that matter, that an RTO or ISO believes that the targeted entity may be responsible for a violation. The Commission stated that it is thus imperative for an RTO or ISO that believes another entity is responsible for a violation to so notify the Regional Entity as soon as possible.¹³ Furthermore, the Commission added, to avoid duplicative investigations and hearings, the Commission does not intend any section 205 direct assignment proceeding to function as a second, de novo review of the investigation. Rather, it clarified such a section 205 proceeding will be limited to the question of whether penalty costs should be assigned to an entity already identified during the investigative or hearing stage of the enforcement process.

8. Second, if the RTO or ISO *itself* is found to be at fault for the violation of a Reliability Standard, or if an entity that is not on the compliance registry contributed to such fault but cannot be assessed a penalty because of its status, and the RTO or ISO is assessed a penalty, the Commission stated that it will entertain section 205 filings by the RTOs and ISOs requesting recovery of the penalty costs by spreading those costs among their members and/or customers. However, the Commission stated that because the enforcement scheme involving Reliability Standards is so new, and because no party yet had experience with the actual assessment of a penalty, any such filing must be addressed

¹³ The Commission stated that the Regional Entity (or NERC if it is acting as the compliance enforcement authority) may then consider the acts or omissions of such entity in the investigative or hearing process, and may assign responsibility to the entity if appropriate.

on a case-by-case basis. In considering such filings, the Commission stated that it will consider such matters as whether the RTO or ISO had a sound compliance program in place to prevent the violations (including, for example, personnel policies that place incentives on employees and management to comply with the rules or risk adverse actions), whether the violations were intentional or grossly negligent, rather than negligent, whether management was involved in the violations, the ability of the RTO or ISO to pay the penalty, and the fairness of the assessment mechanism proposed by the RTO or ISO.

II. NYISO's Proposal

9. NYISO proposes to add a new mechanism to its tariff in order to recoup the cost it incurs for penalties assessed by the Commission, NERC, and/or NPCC for violations of NERC Reliability Standards, as well as other penalties assessed by federal and state regulators. NYISO asserts that its proposal is just and reasonable and fully complies with the Commission's Guidance Order. NYISO states that, as the Guidance Order acknowledges, ISOs are non-profit entities that have no reserves to pay penalties assessed against them and, like similarly situated ISOs and RTOs, NYISO's current cost recovery mechanisms are designed to recover the costs associated with the specific services NYISO provides. NYISO states that there are no current means for it to collect revenues to pay penalty costs it may be assessed for its own violations or because of its role as a registered entity, even if violations are caused by another entity. The proposed tariff amendments would authorize NYISO to make FPA section 205 filings to seek Commission approval to recover such penalty costs using the following recovery mechanisms: first, if NERC or the Regional Entity finds that another entity is at fault, NYISO may file under section 205 for a direct assignment of the costs to that entity, and, second, if NYISO cannot demonstrate that another party is at fault or NYISO itself is at fault, it may file under section 205 to recover those penalty costs on a system-wide basis, as explained in more detail below.¹⁴ NYISO asserts that its proposal also includes provisions similar to those in a recent PJM filing that would enable a Customer or Market Participant to seek direct assignment of penalties to NYISO if NYISO's actions or

¹⁴ NYISO asserts that, while there are differences, its proposal is like proposals submitted by PJM Interconnection, L.L.C. (PJM) and Southwest Power Pool, Inc. (SPP) allowing the RTOs to seek recovery on a case-by-case basis of reliability penalty costs through direct assignment or by recovery from all RTO participants. *Citing PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,260 (2008) and *Southwest Power Pool, Inc.*, 126 FERC ¶ 61,061 (2009).

inactions caused the Customer or Market Participant to incur a penalty for a Reliability Standard violation.¹⁵

A. Direct Assignment

10. For reliability penalties NYISO incurs due to the action or inaction of a Customer, the proposed tariff authorizes NYISO to seek Commission approval in a section 205 filing to directly assign and bill those penalty costs to the offending entity, after providing the entity with the appropriate notice and opportunity to participate in the underlying NERC or NPCC “root cause” proceeding.¹⁶ The proposed new sections require specific notice to Customers that a failure to comply with applicable reliability rules that causes NYISO to incur a penalty may subject Customer to direct assignment of the penalty. All Customers must conform to all applicable Reliability Standards, ISO rules, and any other applicable operating guidelines and requirements of federal and state regulatory authorities.

11. Section 1.3(a) sets forth the conditions that must be met before NYISO can directly allocate penalty costs to a Customer where NERC has determined that the Customer’s conduct contributed to the violation for which the penalty is assessed:

- a. the Customer receives notice and an opportunity to fully participate in the underlying investigation;
- b. the underlying investigation produced a root cause finding, subsequently filed with the Commission, that the Customer contributed to the NERC Reliability Standards violation(s); and
- c. NERC makes a filing at the Commission with the root cause finding that identifies the Customer’s conduct as causing or contributing to the Reliability Standards violation charged against NYISO as the Registered Entity.

¹⁵ Citing *PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,260 (2008).

¹⁶ A “root cause” proceeding is an investigation into the “root cause” of the reliability violation conducted by NERC or its Regional Entity, the Northeast Power Coordinating Council, Inc. (NPCC) pursuant to the Compliance Monitoring and Enforcement Program approved by the Commission, subject to a compliance filing, in *North American Electric Reliability Council*, 119 FERC ¶ 61,060 (2007).

12. Section 1.3(b) provides that NYISO will notify Customers found to have contributed to a violation of NYISO's intent to directly assign the costs of the penalty to the Customer and of the factual basis supporting that assignment. Section 1.3(c) provides that a Customer's failure to participate in the underlying investigation will not preclude a direct assignment. If more than one Customer's conduct is found to have contributed to the violation, section 1.3(d) provides that NYISO shall make an initial apportionment among the Customers on a basis reasonably proportional to the parties' relative fault.

13. Under section 1.3(e), if NYISO and the involved Customer(s) agree on the proportion of penalty cost allocation, such agreement shall be submitted to the Commission pursuant to section 205 for approval. If the parties cannot agree with NYISO's initial apportionment of the penalty based on each party's relative fault, the matter shall be submitted to the Commission pursuant to section 205.

14. Section 1.4 contains reciprocal provisions paralleling section 1.3, providing that a Customer may seek Commission approval through a section 205 filing for the direct assignment of penalties to NYISO if NYISO's actions or inactions caused the Customer to incur a penalty for a Reliability Standard violation. Once the Commission issues a final order allowing the Customer to directly assign penalty costs to NYISO and NYISO has paid such amount, NYISO can then file under section 205 for Commission approval for the recovery of such penalty costs in accordance with section 3 of Schedule 11 providing for allocation to all Customers, as described in the next section below. However, NYISO also proposes to modify section 10.2 of the indemnification provisions of its Tariff to provide that, with respect to indemnification of penalty costs under this new Schedule 11, "the ISO shall not be indemnified in instances of its gross negligence or intentional misconduct."

B. System-Wide Penalty Allocation

15. The second method of recovery of reliability penalties in NYISO's proposal, system-wide allocation, applies to penalties NYISO incurs for reliability violations that are not the fault of a particular, identifiable Customer, or are the fault of NYISO itself. Section 3 authorizes NYISO to seek section 205 Commission approval to recover these penalty costs on a case-by-case basis by spreading the costs among all Customers. The only exception, as noted above, is in instances of NYISO's gross negligence or intentional misconduct.

16. Section 3.1 provides that NYISO may seek Commission approval to pass through certain penalty costs on a case-by-case basis:

- a. where a particular Customer or Customers cannot be identified as the root cause of a penalty assessment against NYISO;

- b. if NYISO is assessed a penalty because of its own action or inaction that resulted in a Reliability Standard violation or a violation of applicable state or federal regulatory requirements; or
- c. if NYISO pays a penalty that is allocated to it under section 1.4 of Schedule 11.

17. Section 3.2 provides that any costs associated with penalties shall be first paid by NYISO, notwithstanding the limitation of liability provisions in the OATT or the Services Tariff. Then, after consultation with the Management Committee and approval by the Commission, NYISO may recover the amount that it paid in penalties pursuant to Schedule 11, or as otherwise approved by the Commission.

18. Section 3.4 states that such penalty costs will be allocated and billed half to all injection billing units and half to all withdrawal billing units (including export and wheel-through transactions). NYISO states that this allocation is based upon stakeholder consensus.

C. Recovery of Penalty Costs Assessed by Other State and Federal Regulatory Bodies

19. In section 2.0 of Schedule 11, NYISO is authorized to seek Commission approval of the recovery of penalties imposed by other regulatory authorities in addition to NERC and the Commission, which NYISO states would include penalties imposed by the New York State Reliability Council (NYSRC) and the New York State Public Service Commission (NYPSC). For example, NYISO states that NYSRC has adopted reliability rules that are more specific or more stringent than NERC standards and NPCC criteria and that, pursuant to section 215(i)(3) of the FPA, NYPSC has adopted the NYSRC Rules as state regulations that can be enforced by NYPSC. NYISO states that NYPSC may assert that it has the ability to impose penalties on NYISO under the New York Public Service Law. Accordingly, section 2.0 of the proposed tariff would give NYISO the authority to seek Commission approval pursuant to section 205, on a case-by-case basis, under the section 3.0 procedures described above for the recovery of such penalty costs.

III. Notice of Filing and Responsive Pleadings

20. The Commission issued notice of NYISO's filing on April 6, 2009, which was published in the *Federal Register*, 74 Fed. Reg. 17,190, on April 14, 2009. Interventions, comments, and protests were due on or before April 22, 2009.

21. NRG Companies,¹⁷ New York Transmission Owners,¹⁸ and the New York Municipal Power Agency and Municipal Electric Utilities Association of New York State (NYMPA) filed timely motions to intervene. The NYPSC filed a timely motion to intervene and comments. The New York State Consumer Protection Board (NYSCP) filed a timely motion to intervene and protest. On May 7, 2009, NYISO filed a Motion for Leave to File Answer and Answer to the comments and protest, respectively, of the NYPSC and the NYCPB. On May 7, 2009, Designated New York Transmission Owners¹⁹ moved to file an answer to the comments of NYPSC. On May 14, 2009, the NYCPB moved to file an answer to the May 7, 2009 NYISO Answer.

IV. Procedural Matters

22. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,²⁰ the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will accept the answers filed, as they may aid in the disposition of the issues raised by the filing.

V. Discussion

23. The Commission accepts NYISO's proposed revisions to its Services Tariff and OATT, to become effective June 1, 2009, as discussed below. NYISO's proposed Schedule 11 and other related tariff changes comply with the directives of the Commission's Guidance Order and provide a just and reasonable mechanism for the recovery of the cost of penalties issued for violation of Reliability Standards.

¹⁷ For purposes of this filing, the NRG Companies are NRG Power Marketing LLC, Arthur Kill Power LLC, Astoria Gas Turbine Power LLC, Dunkirk Power LLC, Huntley Power LLC, and Oswego Harbor Power LLC.

¹⁸ For purposes of this filing, the New York Transmission Owners are the eight electric systems in New York that own the transmission facilities operated by NYISO, as follows: Central Hudson Gas & Electric Corp., Consolidated Edison Company of New York Inc., Orange and Rockland Utilities, Inc., Long Island Power Authority, New York Power Authority, New York State Electric & Gas Corp., Niagara Mohawk Power Corp. d/b/a National Grid, and Rochester Gas and Electric Corp.

¹⁹ Designated New York Transmission Owners refers to all entities that intervened under the New York Transmission Owners group, except for the Long Island Power Authority and New York Power Authority.

²⁰ 18 C.F.R. § 385.214 (2008).

A. Pass-through of NYPSC Penalty Costs to End Users

24. In its Comments, the NYPSC states that it is concerned that penalty costs, which the Commission may authorize recovery of, could be automatically passed through to end-use consumers by Investor-Owned Utilities (LSEs serving native load). The NYPSC argues that allowing the pass through of penalties to end users would discourage compliance. It asserts that penalizing end-use consumers, who do not have an ability to control or influence compliance, would not serve any legitimate purpose and result in unjust and unreasonable charges. In addition, it asserts, end-use consumers would be deprived of the due process requirements that the Commission endorsed in its Guidance Order, which ensure a “targeted entity has been notified during the course of the investigation”²¹ into a potential violation. The NYPSC states that, because the recovery of penalty costs would be recovered under a new rate schedule, it is unclear whether Investor-Owned Utilities would be authorized to pass through those costs to end-use consumers. Accordingly, the NYPSC asserts that, similar to how the NYPSC may prohibit Investor-Owned Utilities from passing along the costs of penalties through retail rates, the Commission should clarify that Investor-Owned Utilities from which the Commission authorizes the recovery of penalties are not authorized to pass through the associated costs to end-use consumers, unless authorized by the NYPSC.

25. In its Answer, the Designated New York Transmission Owners argue that consistent with longstanding judicial and Commission precedent, the Commission should confirm that any costs found just and reasonable, and therefore permissible wholesale NYISO charges, are recoverable by utilities from retail customers as incurred.²² They state that, in *Nantahala*, the Supreme Court found that the Supremacy Clause of the United States Constitution prohibits state regulators from exercising their jurisdiction over the retail electric rates of a company in a manner which is inconsistent with the findings and determinations of the Commission in its regulation of wholesale rates with respect to that same company. Put simply, they assert, the Supreme Court determined that state regulators cannot “trap” costs determined by the Commission to be just and reasonable. They assert that once the Commission approves the inclusion of any costs in NYISO rates as just and reasonable charges, those rates (and all costs included herein) would be recoverable at the retail level under the filed rate doctrine. Thus, they assert, the right of regulated utilities to recover Commission approved wholesale charges at the retail level is well settled. They assert that in reviewing NYISO’s determination to

²¹ Guidance Order, 122 FERC ¶ 61,247 at P 23.

²² Citing *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 970 (1986) (*Nantahala*).

reallocate a penalty, the Commission may consider whether this will weaken incentives for NYISO to comply with Reliability Standards and whether this will result in just and reasonable rates. However, they conclude, once the Commission determines that the reallocation of the penalty cost is just and reasonable, there is no justification for denying regulated utilities, which were not responsible for the Reliability Rule violation, from recovering that cost at the retail level.

26. In its May 7, 2009 Answer, NYISO states that no clarification is needed that the Commission does not have jurisdiction over retail rates. Further, it states that its filing does not request approval to pass through the cost of any penalties and merely establishes the mechanism for seeking approval to recover such costs in the future.

27. The Commission finds that the section 205 filing procedure section 2.0 establishes is just and reasonable. NYISO's proposal does not grant Investor-Owned Utilities the authority to automatically pass through such penalty costs to end users and the NYPSC may intervene in any NYISO section 205 proceeding where such a cost allocation is proposed and may raise any concerns there. Accordingly, we will defer all issues relating to cost recovery, including the preemption doctrine and its application to the recovery of NYPSC reliability penalties assessed NYISO, to the future section 205 proceedings contemplated by section 2.0. Further, we clarify that such proceedings under section 2.0 only concern issues regarding the recovery of the cost of any such penalty and not the imposition of the penalty itself.

B. NYPSC Penalty Recovery

28. NYPSC is concerned that NYISO's proposal to be able to seek the Commission's approval to recover penalties NYISO incurs in connection with reliability rules approved by the NYPSC or the NYSRC would usurp the NYPSC's authority. NYPSC states that the FPA limits the Commission's authority to impose penalties in connection with a violation of a "reliability standard," which is defined as a "requirement approved by the Commission."²³ NYPSC argues that, accordingly, "the Commission's penalty authority is limited to where the Commission has approved the reliability standard that was violated." The NYPSC asserts that NYISO's filing would impermissibly expand the Commission's authority under the FPA and, therefore, asks the Commission to reject this provision of NYISO's Filing.

29. In its May 7, 2009 Answer, NYISO argues that the NYPSC's argument is without merit. NYISO states that RTOs and ISOs are "federal entities, created and regulated by

²³ NYPSC April 22, 2009 Comments at 7 (citing 16 U.S.C. 824o(e)(3)).

the Commission.”²⁴ It states that the Commission has exclusive jurisdiction to allow or disallow NYISO the recovery of an item of costs in its rate schedules, including the costs of penalties, regardless of whether the Commission has jurisdiction to levy or review the penalty itself. Thus, it asserts that a proposal to modify NYISO’s tariffs to recover the costs of reliability penalties from any source is wholly within the Commission’s jurisdiction. NYISO notes, too, that it is not here proposing to recover any penalty costs and that NYPSC retains its right to intervene and oppose such recovery in any section 205 proceeding in which NYISO does propose to recover such penalty costs. Finally, NYISO notes that NYPSC did not raise such objections at any time throughout the stakeholder process that resulted in the instant tariff proposal.

30. NYISO’s proposed section 2.0 establishes a section 205 filing mechanism permitting NYISO to seek recovery of the cost of reliability penalties it pays other regulatory entities, including the cost of penalties imposed by the NYPSC. In such section 205 proceedings, the Commission is not thereby imposing its own penalties or otherwise usurping any power of the NYPSC to impose penalties; the Commission is asserting its exclusive jurisdiction over jurisdictional rates and charges of an ISO. Jurisdictional rates and charges are designed to recover costs of performing jurisdictional service and may include costs that are imposed on a jurisdictional entity by entities other than the Commission. For example, the Commission is not “imposing” income taxes when it permits the jurisdictional entity to recover the cost of such taxes in its jurisdictional rates. Thus, because a reliability penalty imposed by the NYPSC is a cost to a jurisdictional entity, NYISO, the Commission has jurisdiction over the matter of the recovery of such cost by NYISO. Further, as noted above, proposed section 2.0 only establishes procedures for NYISO to file such reliability penalty cost recovery proposals under section 205 of the FPA and does not automatically authorize such recovery. Finally, although the Guidance Order did not expressly address ISO/RTO recovery of the cost of state reliability penalties, and only dealt with FERC, NERC, or Regional Entity penalties, the principles and guidance of that order apply as well to the recovery of the cost of state reliability penalties (including, therefore, the cost of reliability penalties imposed by the NYPSC).

31. If and at such time that NYPSC imposes such a reliability penalty on NYISO, NYISO may file a section 205 proposal under section 2.0 to seek to recover such cost and the Commission will review at that time whether the recovery of such cost, and the related cost allocation and recovery mechanism, is just and reasonable. The NYPSC may intervene in the proceeding and may raise any concerns there. We clarify that the other parts of Schedule 11 providing procedures to review determinations by NERC, etc., to

²⁴ NYISO May 7, 2009 Answer, at 7.

impose penalties in the first place do not apply to NYPSC-imposed penalties and that section 2.0 of Schedule 11 only concerns procedures for the recovery of such costs by NYISO as found in section 3.0 of Schedule 11. Moreover, the Commission takes no position here on whether any particular reliability-related penalty NYPSC imposes on NYISO may or may not be within NYPSC's jurisdiction to impose or whether the rate treatment of such cost, and the rate mechanism for such rate treatment, by NYISO is just and reasonable.

C. Allocation when NYISO is at fault

32. NYSCPБ protests NYISO's proposal to recover penalty costs in situations where NYISO is demonstrably at fault. NYSCPБ argues that "failure should not be rewarded."²⁵ The NYSCPБ urges FERC to require that NYISO file a penalty payment plan that more closely aligns causation and consequences, such as by modifying NYISO management compensation. NYSCPБ states that a process that increases rates by assigning penalties incurred due to NYISO's behavior is, by definition, unjust and unreasonable and is especially without justification when it shifts penalty costs to blameless consumers. Finally, NYSCPБ argues, the proposal discourages NYISO from complying with regulations and burdens third parties to vigilantly monitor the section 205 filings that NYISO would file in order to oppose each penalty pass-through.

33. In its May 7, 2009 Answer, NYISO counters that it already has modified management compensation in a manner similar to what NYSCPБ demands. NYISO states that its board approved a statement holding that, if NYISO were to "cause the imposition of a NERC Reliability Standards penalty," that NYISO would reduce "the annual incentive amount equal to the level of the penalty."²⁶ Therefore, NYISO states, it is not rewarding failure, as NYSCPБ accused it of doing. NYSCPБ, in its Answer to NYISO's Answer, interprets NYISO's Answer as holding that "NYISO's violations of NERC Reliability Standards are to be paid by management," and that therefore NYISO's tariff filing requesting recovery authority "is moot."²⁷

34. In the Guidance Order, the Commission announced, that it "will, as with section 205 filings providing for direct assignment, entertain section 205 filings by the RTOs and ISOs requesting recovery of penalty costs by spreading those costs among their members

²⁵ NYSCPБ April 22, 2009 Protest at 7.

²⁶ NYISO May 7, 2009 Answer at 7.

²⁷ NYSCPБ May 14, 2009 Answer at 4.

and/or customers.”²⁸ The Commission stated that it would review such requests on a case-by-case basis, and listed some of the criteria that it would use:

- a. whether the RTO or ISO had a sound compliance program in place to prevent the violations (including, for example, personnel policies that place incentives on employees and management to comply with the rules or risk adverse actions),
- b. whether the violations were intentional or grossly negligent, rather than negligent,
- c. whether management was involved in the violations,
- d. the ability of the RTO or ISO to pay the penalty, and
- e. the fairness of the assessment mechanism proposed by the RTO or ISO.²⁹

35. Accordingly, proposals such as NYISO’s to establish filing procedures to recover reliability penalty costs in instances where the RTO or ISO is demonstrably at fault are not barred under the Guidance Order, and we have accepted a proposal for similar filing authority when, as here, the proposal was approved by the RTO’s or ISO’s stakeholder process.³⁰ We note with approval that NYISO proposes to modify its indemnification language, in section 10.2, to state that “the ISO shall not be indemnified in instances of its gross negligence or intentional misconduct.” The Commission also notes with approval NYISO’s commitment, stated in its May 7, 2009 Answer, to reduce the incentive portion of executive compensation by the amount of its NERC violations. NYSCPB is incorrect in arguing that NYISO’s internal policy renders the tariff request moot – among other reasons, it is possible that in a given year NYISO could be assessed Reliability Standards penalties that exceed the incentive portion of its executives’ compensation. The Commission also notes that NYISO, as a not-for-profit, has less of an ability to pay penalties than its customers or members may, which could mean that in some future cases a broad allocation of penalty costs could be warranted. Finally, the

²⁸ Guidance Order, 122 FERC ¶ 61,247 at P 27.

²⁹ *Id.*

³⁰ See *PJM Interconnection, L.L.C.*, 124 FERC ¶ 61,260, at P 16 (2008) (*PJM*). Cf. *Southwest Power Pool, Inc.*, 126 FERC ¶ 61,061, at P 29 (2009)(rejecting reciprocity penalty cost recovery provision where, unlike in *PJM*, the provision was not approved by the shareholder process).

proposed assessment rates (half to all injection billing units and half to all withdrawal billing units) are unopposed as a general matter, and the Commission would still have the power to modify the assessment on a case-by-case basis if for some reason the default assessment rates were to prove unjust or unreasonable in a specific instance.

36. The Commission shares NYSCP B's concern about discouraging NYISO's resolve to comply with Reliability Standards and to prevent violations. The proposed tariff, however, provides the Commission with a constant check on NYISO's behavior. NYISO must come before the Commission in each instance that it seeks to pass through a penalty, and have the request be considered under FPA section 205 on a case-by-case basis. If the Commission were ever to find that NYISO became lax in its pursuit of reliability, as NYSCP B fears, then the Commission could simply deny relief or take other appropriate action. While this approach may require increased vigilance, it also serves to ensure that the means of allocating penalties are indeed leading to the desired ends of increased and sustained reliability in NYISO region. Accordingly, this aspect of the proposed tariff is just and reasonable.

The Commission orders:

NYISO's proposed tariff sheets are accepted to become effective June 1, 2009, as requested, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.