

122 FERC ¶ 61,247
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

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

ORDER PROVIDING GUIDANCE ON RECOVERY OF RELIABILITY PENALTY
COSTS BY REGIONAL TRANSMISSION ORGANIZATIONS AND INDEPENDENT
SYSTEM OPERATORS

(Issued March 20, 2008)

1. The Commission issues this order to provide guidance to Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs) concerning cost recovery for penalties which may be assessed against them pursuant to section 215 of the Federal Power Act (FPA)¹ for noncompliance with mandatory and enforceable Reliability Standards. The Commission recognizes the importance of RTOs and ISOs in providing transmission service, enhancing reliability and administering electric energy markets throughout the country, and acknowledges that these entities, to the extent they operate as not-for-profit organizations funded by their customers, may have insufficient reserves to pay penalties assessed pursuant to section 215 of the FPA. Nonetheless, a blanket exemption from the payment of reliability-related monetary penalties could have adverse consequences for the Bulk-Power System, as it would reduce the incentive for RTOs and ISOs and their employees to comply with applicable Reliability Standards. In this order, we suggest mechanisms by which RTOs and ISOs may seek to avoid the incurrence of reliability-related monetary penalties, and provide procedures by which they may seek to recover the costs of any penalties that are assessed.

I. Background

2. Section 1211 of the Energy Policy Act of 2005 (EPAct 2005)² 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

¹ 16 U.S.C. § 824o (Supp. V 2005).

² Pub. L. No. 109-58, §1211, 119 Stat. 594, 941 (2005).

Commission. Penalties for violations of Reliability Standards are to be imposed by the ERO, subject to Commission approval.³ On July 20, 2006, the Commission certified the North American Electric Reliability Corporation (NERC), as the ERO.⁴

3. In Order Nos. 672 and 672-A,⁵ which implemented the requirements of EPAct 2005 regarding the selection, standard-setting procedures and operational aspects of the ERO, the Commission denied requests to: (i) exempt non-profit RTOs and ISOs from monetary penalties for violations of the Reliability Standards; and (ii) authorize RTOs and ISOs to recover such monetary penalties from their customers on a generic basis. Rather, the Commission stated it would consider on a case-by-case basis proposals under section 205 of the FPA⁶ by RTOs and ISOs to recover the costs of any monetary penalties that may be imposed on them for the violation of Reliability Standards.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, such as generator owners, transmission owners, transmission operators and reliability coordinators. RTOs and ISOs, each of which is a transmission service provider, have been registered by NERC to comply with the Reliability Standards that apply to that function, as well as other functions as appropriate.⁸ Thus, an RTO or ISO that fails to comply with the requirements of the applicable Reliability Standards may be assessed a penalty by a Regional Entity, the ERO or the Commission pursuant to section 215(e) of the FPA.

³ The Commission, on its own motion, may also investigate violations of the Reliability Standards and impose penalties. 16 U.S.C. § 824o(e)(3) (Supp. V 2005).

⁴ *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062, *order on reh’g*, 117 FERC ¶ 61,126 (2006).

⁵ *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).

⁶ 16 U.S.C. § 824d (2005).

⁷ Order No. 672 at P 634-35; Order No. 672-A at P 55-58.

⁸ RTOs and ISOs may be registered for other functions, as well. For instance, the New York Independent System Operator has been registered in the Northeast Power Coordinating Council as a Reliability Coordinator, a Transmission Planner, a Resource Planner, a Planning Authority, a Balancing Authority, and a Transmission Operator.

5. The RTO or ISO, as the entity registered by NERC, is responsible for compliance with the Reliability Standards that apply to transmission service providers and Reliability Standards that apply to other functions for which it is registered. It is possible that another entity within an RTO or ISO footprint, not registered as a transmission service provider, is delegated to perform a specific task related to the transmission service provider function, while the RTO or ISO retains responsibility as the registered entity for that function. Thus, it is possible that the acts or omissions of such an entity could result in RTO or ISO non-compliance with a Reliability Standard.

6. On April 2, 2007, Midwest Independent Transmission System Operator, Inc. (Midwest ISO) filed proposed tariff changes which would have allowed recovery of the costs of any monetary penalties assessed against it pursuant to section 215 of the FPA, either from specific tariff customers that Midwest ISO deemed responsible for Midwest ISO's incurrance of the reliability-related monetary penalty or, if Midwest ISO were unable to identify such customers, from all tariff customers allocated according to their level of transmission usage or market participation. The Commission rejected Midwest ISO's request without prejudice and, because of the importance of the question, established in Docket No. AD07-12-000 a staff technical conference to explore generically the issues raised by Midwest ISO's filing.⁹

7. Staff convened the technical conference on September 18, 2007. Participants in the conference included representatives of the RTOs and ISOs, entities potentially subject to paying reliability-related monetary penalties incurred by the RTOs and ISOs, and NERC and several Regional Entities to which the ERO has delegated enforcement functions.¹⁰ Written comments were filed after the conference.

8. A variety of views were expressed at the conference and in the written comments. A number of parties assert that RTOs and ISOs should not be exempt from monetary

⁹ *Midwest Independent Transmission System Operator, Inc.*, 119 FERC ¶ 61,222, at P 21 (2007).

¹⁰ Delegation of the ERO's enforcement authority is permitted under section 215(e)(4) of the FPA, 16 U.S.C. § 824o(e)(4) (2005). The eight Regional Entities to which NERC has delegated enforcement authority are: Texas Regional Entity, Midwest Reliability Organization, Northeast Power Coordinating Council, Inc., ReliabilityFirst Corporation, SERC Reliability Corporation, Southwest Power Pool, Inc., Western Electricity Coordinating Council, and Florida Reliability Coordinating Council.

penalties for Reliability Standards violations.¹¹ However, some of these parties suggest that monetary penalties should only be assessed when other remedial measures (*i.e.*, non-monetary penalties) are likely to be ineffective.¹² In contrast, other parties take the position that only non-monetary penalties should be assessed when a not-for-profit RTO or ISO causes a Reliability Standard violation.¹³

9. The parties largely support, or do not oppose, direct assignment of penalty costs to other parties – parties to which the RTO or ISO delegated certain tasks – where the performance of those parties is responsible for the RTO or ISO’s having violated a Reliability Standard. However, a number of these parties state that the Commission should not permit an RTO or ISO to directly assign a reliability-related monetary penalty to another organization where there is no factual basis for the assignment in the Regional Entity or NERC investigation record and where that other organization did not have the opportunity to participate in the investigation.¹⁴ For example, FirstEnergy asserts that an RTO or ISO should not have the authority to initiate a separate fact-finding process for the purpose of attempting to allocate responsibility for a penalty to a third party. CenterPoint argues that a Regional Entity should perform a comprehensive, root-cause investigation of all possible violations of Reliability Standards. The Regional Entity should include all entities identified as possibly involved by action or inaction in the violation of a Reliability Standard in the process of determining whether a violation occurred and the responsible entities. Thus, according to CenterPoint, any entity,

¹¹ See, e.g., Comments of Cities of Anaheim, Azusa, Banning, Colton, Pasadena and Riverside, California (Six Cities) at 5-8, Comments of Community Power Alliance Members at 3-8, Comments of Edison Electric Institute (EEI) at 4-5, Initial Comments of Exelon Corporation (Exelon) at 4, Comments of FirstEnergy Companies (FirstEnergy) at 4-6, and Comments of Oncor Electric Delivery Company (Oncor) at 2.

¹² See, e.g., Comments of Cities of Six Cities at 5-8, Comments of FirstEnergy at 4-6, and Comments of Oncor at 2.

¹³ See, e.g., Comments of the Midwest ISO Transmission Owners (Midwest ISO TOs) at 5-6, and Comments of New York Independent System Operator, Inc. (NYISO) at 9-10.

¹⁴ See, e.g., Comments of American Municipal Power–Ohio, Inc. (AMP-Ohio) at 6-8, Comments of CenterPoint Energy Houston Electric, LLC (CenterPoint) at 2-4, Comments of EEI at 8-10, Comments of Exelon at 5-7, Comments of FirstEnergy at 2-4, Comments of Kansas City Power & Light Company (KCP&L) at 6-9, Comments of Midwest ISO TOs at 2-5, and Comments of Six Cities at 11.

regardless of functional registration, should be investigated and afforded due process. Both at the technical conference and in written comments filed afterwards, NERC stated that it is committed to uncovering the root causes of Reliability Standard violations.¹⁵

10. Some parties also assert that the potential for a reassignment of a reliability-related monetary penalty must be part of an agreement among the involved parties or a tariff filing that provides adequate notice that such costs could be reassigned and the basis for the reassignment.¹⁶ Some of these parties also request that separate section 205 filings should be required for any reassignment or pass through of penalty costs to ensure that the pass-through is just and reasonable.¹⁷

11. Conversely, other parties argue that no reassignment of reliability-related monetary penalties should be necessary inasmuch as the Regional Entity should in the first instance have assigned blame where it properly belonged and that NERC enforcement procedures should be revised to ensure that unregistered entities are assessed appropriate penalties if they cause a violation of a Reliability Standard.¹⁸ The IRC disagrees with NERC that it could find an RTO or ISO responsible and subject to a penalty if a Reliability Standard had been violated even though the violation was not caused by the RTO or ISO.¹⁹

12. The IRC states that its members are working with companies in their regions to better identify the split of responsibilities for various Reliability Standards.²⁰ The IRC strongly supports the goal of connecting responsible entities with Reliability Standards to the fullest extent possible. However, it states that it is also clear at this juncture that it is possible that an entity registered for a given function may not in fact be the cause of or

¹⁵ Comments of NERC at 7-10.

¹⁶ *See, e.g.*, Comments of American Electric Power Service Corporation, The Empire District Electric Company, Oklahoma Gas and Electric Company, and Midwest Energy, Inc. (together, AEP, *et al.*), at 7, Comments of EEI at 9, Comments of Exelon at 5-6, Comments of Midwest ISO at 4, and Comments of Six Cities at 9-10.

¹⁷ *See, e.g.*, Comments of Exelon at 6, Comments of Midwest ISO at 6, and Comments of Six Cities at 12-13. *See also* Comments of Midwest ISO TOs at 7-8 and Comments of AMP-Ohio at 7.

¹⁸ *See, e.g.*, Comments of KCP&L at 7, and Comments of ISO/RTO Council (IRC) at 5-10.

¹⁹ Comments of ISO/RTO Council (IRC) at 5-10.

²⁰ *Id.* at 8.

primary contributor to a violation of a Reliability Standard.²¹ While the IRC supports NERC's offer to investigate beyond the registry to determine causation of violation of a Reliability Standard, the IRC notes that NERC's efforts with respect to an unregistered but wrong-doing entity should not be limited to registering that entity going forward – which IRC believes in many circumstances might not be appropriate; IRC thus believes that the NERC investigation may simply give the entity that is the root cause of the violation of a Reliability Standard a pass for that violation.²² IRC believes such situations illustrate either that the compliance registry is a non-exclusive tool when determining enforcement action, or that more work is needed to develop even more granular standards for use in RTO and ISO regions to ensure that those with key reliability responsibilities are held accountable through the requirements of every standard, and, in so doing improve reliability.²³

13. Similarly, NYISO, Midwest ISO and ERCOT, and certain transmission-owning members of RTOs or ISOs, argue that NERC may impose reliability-related monetary penalties on registered entities for Reliability Standard violations for functions for which they are registered entities regardless of whether NERC identifies the entity as the “root cause” of the violation. They submit that penalizing entities that have no control over violations serves no legitimate purpose and that if NERC does not want an RTO or ISO to apportion responsibility for a violation outside the NERC enforcement process, then NERC must determine which entity is at fault and ensure that only that entity is subject to penalties. They state that the Commission should require NERC to establish a policy against assessing reliability-related monetary penalties on registered entities for violations when NERC finds that the root cause of the violation is the action or inaction of an unregistered entity.²⁴

14. Some parties suggest mechanisms by which RTOs and ISOs can avoid violating Reliability Standards. AEP *et al.*, state that proactive involvement of the RTO or ISO board of directors would ensure a greater degree of accountability by RTO/ISO management in maintaining the reliability of the transmission system and reducing the incidence of Reliability Standard violations.²⁵ Six Cities believe that to properly

²¹ *Id.*

²² *Id.* at 9.

²³ *Id.* at 10.

²⁴ Comments of NYISO, Midwest ISO and the Electric Reliability Council of Texas (ERCOT) at 3-5, Comments of Transmission Owners within ERCOT at 1-2, and Comments of Indicated PJM Transmission Owners at 2-7.

²⁵ Comments of AEP, *et al.*, at 4, 8.

encourage RTO and ISO compliance with Reliability Standards, a portion of the discretionary compensation of senior management-level employees of RTOs and ISOs should be tied to the RTO's or ISO's compliance with Reliability Standards.²⁶ Similarly, Midwest ISO TOs argue that if a Reliability Standard violation is caused by an RTO or ISO, the RTO or ISO should factor that violation into its incentive compensation determination.

15. Midwest ISO states that permitting an RTO or ISO to pass through penalties assessed under section 215 of the FPA will not diminish the organization's accountability because RTO/ISO's managers are accountable to their boards of directors and the boards of directors are accountable to the RTO/ISO members.²⁷ If a penalty assessed under section 215 of the FPA is not directly assigned, Midwest ISO states that the cost of the penalty should be allocated pro rata to all market participants that engaged in market activities during the period of time the event associated with the penalty occurred.²⁸

II. Discussion

16. After consideration of the views expressed both at the technical conference and subsequently in filed written comments, and in light of our enforcement policies generally,²⁹ the Commission will provide the following guidance to RTOs and ISOs regarding recovery of the costs of reliability-related monetary penalties.³⁰ Although RTOs and ISOs have raised legitimate concerns regarding their not-for-profit status and potential ambiguities in defining the responsibility for certain violations, we are concerned that RTOs and ISOs will not have the appropriate incentives to proactively comply with Reliability Standards if they have blanket authority to automatically pass through monetary penalties to their customers. Accordingly, as discussed below, we will not allow RTOs and ISOs to adopt tariff mechanisms that provide automatic recovery of penalties incurred for Reliability Standard violations and will instead require that proposals to recover any such penalties be filed case-by-case. In evaluating such

²⁶ Comments of Six Cities at 10.

²⁷ Comments of Midwest ISO at 3-4.

²⁸ *Id.* at 4.

²⁹ *Policy Statement on Enforcement*, 113 FERC ¶ 61,068 (2005).

³⁰ As explained further below, the Commission expects RTOs and ISOs to proactively maintain comprehensive internal compliance programs to avoid violation of Reliability Standards in the first instance and thus minimize the incurrence of penalties assessed pursuant to section 215.

proposals, the Commission will consider, among other things, the nature of the Reliability Standard violation and the factors that contributed to the violation, including the integrity of the RTO or ISO's compliance program to prevent such violations.

17. In order to understand the implications of a request by an RTO or ISO for recovery of reliability-related monetary penalty costs, it is necessary to first understand how violations of Reliability Standards are investigated and, if necessary, prosecuted. Under a series of orders issued in response to filings by NERC, the Commission has approved a three-tiered approach to a Regional Entity's investigation of and fixing responsibility for Reliability Standards violations. Generally, when faced with a possible Reliability Standard violation, the Regional Entity responsible for the geographical area in which the violation occurred conducts an investigation or other inquiry into the triggering matter. If the Regional Entity's compliance staff finds that an entity that is on NERC's compliance registry committed a violation of a Reliability Standard for which it is registered, the matter is resolved either by a settlement agreement or a contested hearing. All settlements are reported to NERC, which can approve the settlement or reject it and send it back for further consideration.

18. If a penalty is assessed after a hearing, the registered entity can appeal the decision to NERC, which either affirms the penalty or remands the decision back to the Regional Entity with reasons for its decision.³¹ When the appeal to NERC has been resolved and a penalty affirmed, NERC files a notice of penalty with the Commission. This penalty becomes effective after 30 days following its filing with the Commission or, if either the registered entity seeks review of the penalty or the Commission decides to review it, upon final determination by the Commission.³² The Commission essentially serves as an appellate body in ruling on a notice of penalty, reviewing the record created by the Regional Entity and by NERC and entertaining reasons to affirm, modify or set aside the penalty.³³

19. Both in testimony at the technical conference and in written comments filed afterwards, NERC stated that it is committed to uncovering the causes of Reliability Standards violations. NERC affirmed that both it and the Regional Entities will conduct thorough investigations which will examine the "root cause" of a violation. NERC stated that, while RTOs as registered entities would be liable for penalties that apply to functions for which they are registered, NERC and the Regional Entities would extend

³¹ NERC Compliance Monitoring and Enforcement Program (CMEP), Sec. 5.5. The CMEP was approved by the Commission, subject to a compliance filing, in *North American Electric Reliability Council*, 119 FERC ¶ 61,060 (2007).

³² See 18 C.F.R. § 39.7(e)(1) (2007); CMEP, Sec. 5.6

³³ See 16 U.S.C. § 824o(e)(2) (Supp. V 2005); 18 C.F.R. § 39.7 (2007).

the investigation to entities that are not on the compliance registry if that proved necessary. NERC also pointed out that, even though a monetary penalty may not be assessed against an entity that is not on the compliance registry, *i.e.*, an entity that is not registered,³⁴ if such an entity is found to be responsible for a violation that entity may be added to the compliance registry and a mitigation plan put into place to prospectively address the non-compliance.

20. In the event NERC assesses a monetary penalty against an RTO or an ISO, and the RTO or ISO cannot pay the penalty itself, the question arises as to how the RTO or ISO will recover the costs of the penalty. At the technical conference and in the filed written comments, two possible methods have been suggested, one being the direct assignment of such costs to an entity that the RTO or ISO believes to be responsible for incurrence of the violation, and the other being a recovery of such costs from all members and/or customers of the RTO or ISO.

A. Direct Assignment of Reliability-Related Monetary Penalty Costs

21. The first method suggested, that of directly assigning the monetary penalty costs to an entity that the RTO or ISO deems to be responsible for the violation, was proposed by Midwest ISO in its tariff filing. Midwest ISO proposed that it conduct its own internal investigation to determine the responsible party, and that, once it made that determination, it be permitted to make a direct assignment of the penalty costs to that entity, subject to approval by the Commission in a section 205 filing.³⁵

22. NERC opposes RTOs and ISOs conducting their own inquiries to assess responsibility for violations of the Reliability Standards, arguing that this would be unnecessary and duplicative of the Commission-approved NERC procedures. The Commission agrees with NERC that duplicative investigations and hearings to assess responsibility should be avoided.³⁶ The Commission has taken steps to ensure that the investigation and hearing process to be employed by NERC and the Regional Entities will be thorough and accurate and will comport with the requirements of due process.³⁷

³⁴ See *Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242, at P 97, *order on reh'g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

³⁵ Midwest Independent Transmission System Operator, Inc., Electric Tariff Filing on Schedule 10 Passthrough of Electric Reliability Organization Penalties, Docket No. ER07-701-000 (April 2, 2007) (Midwest ISO Tariff Filing).

³⁶ See Order No. 672 at P 485.

³⁷ See *id.* at P 450-638.

To permit an RTO or ISO to conduct its own separate investigation would unnecessarily duplicate and potentially undercut that process. Furthermore, when NERC files a notice of penalty with the Commission, to the extent an RTO or ISO disagrees with a penalty or its assignment, it may utilize the Commission's review process to challenge NERC's and the Regional Entity's determination of responsibility for a Reliability Standard violation and any associated penalty assessment. The Commission, however, does not believe the RTO or ISO should be permitted to pursue a second, de novo hearing on the issue of determining responsibility for Reliability Standard violations.

23. In the event an RTO or ISO itself is assessed a monetary penalty, the Commission will entertain a section 205 filing by that RTO or ISO to directly assign the costs of the penalty to another entity. However, to ensure due process to that targeted entity, the Commission 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. 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.³⁸ Furthermore, to avoid duplicative investigations and hearings, the Commission repeats that it does not intend any section 205 direct assignment proceeding to function as a second, de novo review of the investigation. Rather, 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.

24. The Commission has ruled, moreover, that neither NERC nor the Commission may assess a penalty for the violation of a Reliability Standard against an entity which is not registered as the responsible party for complying with that Standard.³⁹ Similarly, we will not allow the direct assignment of penalty costs to another entity under section 205 unless that entity had previously been put on notice of its potential liability for penalty costs in the event that it contributed to the RTO or ISO's violation of a Reliability

³⁸ 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.

³⁹ Order No. 693 at P 97 (“While the Commission may take prospective action against an entity that was not previously identified as a user, owner or operator through the NERC registration process once it has been added to the registry, the Commission 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 there is an entity that is not registered and NERC later discovers that the entity should have been subject to the Reliability Standards, NERC has the ability to add the entity, and possibly other entities of a similar class, to the registration list and to direct corrective action by that entity on a going-forward basis.”).

Standard and incurrence of the penalty. It is therefore important for the RTOs and ISOs to include provisions regarding the appropriate responsibility for reliability-related monetary penalties in their contracts with their members and customers and/or in their tariffs, including provisions regarding the appropriate responsibility for such penalties on the ISOs and RTOs.⁴⁰ The Commission further encourages RTOs and ISOs to utilize, as appropriate, the joint registration provisions of NERC's Rules of Procedure, which permit more than one entity to share responsibility for compliance with particular Reliability Standards and which could facilitate identifying the entity or entities that were responsible for a violation of a Reliability Standard and that should be assessed any monetary penalty in the Reliability Standard enforcement proceeding.⁴¹ We expect that potential joint registrants will recognize the benefits of an appropriate allocation of responsible, and thus enter into appropriate joint registration arrangements.

B. Recovery of Reliability-Related Monetary Penalty Costs that Cannot be Directly Assigned

25. The second method for passing on the costs of reliability-related monetary penalties assessed against RTOs and ISOs is spreading those costs among all the members or customers of the organization. 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, then the RTO or ISO may be assessed a penalty. In its tariff filing, Midwest ISO proposed a new tariff provision permitting it to recover the costs of such a penalty from its customers, allocated according to their level of transmission usage or market participation.

26. The Commission has concerns with this approach. Penalties are designed to encourage compliance with the Reliability Standards. If an RTO or ISO knows it could simply pass through the costs of those penalties, the incentive to comply with the Reliability Standards would be reduced. On the other hand, the Commission is mindful of the fact that some RTOs and ISOs operate as not-for-profit organizations, which may well find payment of substantial penalties difficult if not impossible to make. Thus, an organization's ability to pay a penalty is already a factor in the ERO's determination of

⁴⁰ It is the responsibility of registered entities in general, and certainly RTO/ISOs as registered entities, to comply with Reliability Standards for which they are registered and to ensure, contractually or otherwise, that other entities that may be partly or wholly responsible for such compliance will perform in compliance with the applicable Reliability Standards. In addition, any contract and/or tariff mechanisms to reassign penalty responsibility must not be unduly discriminatory.

⁴¹ See Comments of the North American Electric Reliability Corporation, Docket No. AD 07-12-000 at 8-11 (Nov. 6, 2007).

the appropriate penalty,⁴² which, we emphasize as well, may include or be entirely non-monetary penalties. There are also mechanisms which the RTOs and ISOs may employ on a proactive basis to prevent the incurrence of penalties. For instance, RTO/ISO boards of directors and management may incorporate policies for planning and operation of the bulk power system in compliance with Reliability Standards as a significant part of the RTO/ISO staff and management performance evaluations and compensation programs, as part of an effective internal compliance program. Bonuses and other incentives received by senior management could also be made contingent on penalty-free operations. Such practices could substantially lessen the likelihood of employee and/or management behavior that results in violations. Another mechanism is the inclusion of indemnification provisions in membership or formation agreements of the RTOs and ISOs, obligating the members to cover the costs of any reliability penalties which may be assessed against the RTO or ISO. Such agreements could, through their negotiation in exchange for indemnification, include measures to ensure that adequate internal compliance incentives are put in place by the RTO or ISO.

27. While the Commission favors the foregoing, the Commission 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 and/or customers. Because the enforcement scheme involving Reliability Standards is so new, and because no party has experience with the actual assessment of a penalty, any such filing must be addressed on a case-by-case basis. In considering such filings, the Commission 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.

III. Conclusion

28. The Commission recognizes that enforcement of mandatory Reliability Standards is at its beginning. However, the importance of RTOs and ISOs and their possible inability to pay reliability penalties, given that they may be non-profit, has made it

⁴² NERC Sanction Guidelines, sec. 4.4.1. The Sanction Guidelines were approved, subject to a compliance filing, by the Commission in *North American Electric Reliability Corp.*, 121 FERC ¶ 61,033 (2007).

imperative to provide some initial guidance as to the cost recovery of reliability-related monetary penalties assessed against them. This order provides such guidance with the recognition that experience may necessitate adjustments in the future.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.