



Memorandum

To: Gerry W. Cauley, President and Chief Executive Officer, NERC
From: ISO/RTO Council
Subject: NERC and Regional Reliability Entity Compliance Monitoring and Enforcement Procedures
Date: July 12, 2010
Copies: David Cook, NERC, IRC Regulatory and Legislative Committee

On January 23, 2009, the ISO/RTO Council (“IRC”) submitted to Richard Sergel the attached Memorandum to advance the IRC’s ongoing discussions with NERC, the Federal Energy Regulatory Commission (“FERC” or “Commission”) and the Regional Entities regarding the need for a fair and equitable means for RTOs and ISOs to allocate the cost of NERC penalties among RTO/ISO market participants, particularly in an instance where actions of a specific market participant, rather than the RTO/ISO, caused the penalty to be incurred.¹ Prior to the January 23, 2009 Memorandum, the IRC raised this issue on a number of occasions to FERC both in the context of generic comments and in the context of RTO specific filings undertaken by Midwest ISO and PJM. On October 20, 2009, representatives of the IRC met with NERC and FERC Staff, including the FERC’s General Counsel, Thomas Sheets, and NERC’s General Counsel, David Cook.

At the October 20th meeting, we discussed the changes that are needed to NERC and (potentially) Regional Entity Compliance Monitoring and Enforcement Procedures and Hearing Procedures to enable RTOs/ISOs who are Registered Entities, but rely on their members to perform certain Reliability Standards compliance tasks, to allocate the costs of NERC penalties as permitted by the FERC’s March 20, 2008 order in Docket No. AD07-12-000 (“Guidance Order”). The IRC believes that changes to the NERC’s procedural rules are needed to provide a right of certain parties such as RTO/ISO members to intervene in NERC’s compliance enforcement proceedings. The current procedural rules prohibit such parties from intervening in compliance proceedings absent a FERC authorization. Thus, a formal petition to FERC for permission to intervene at the NERC level is required even when a party may be financially responsible to the RTO/ISO Registered Entity for any penalties that may be assessed.

As fully discussed in the January 23, 2009 Memorandum, this outcome is inconsistent with FERC’s directives and orders which make clear the need for NERC’s Compliance Proceedings (and the Regional Entities’ processes, if applicable) to provide an opportunity for an RTO’s/ISO’s members to fully participate in the Compliance Proceedings, *at every stage*, when such entities may be financially responsible for reliability violation penalties assessed against an RTO/ISO as the Registered Entity. This is appropriate because the actions of RTO/ISO

¹ The Independent System Operator operating as the Alberta Electric System Operator (“AESO”), Ontario Independent Electricity System Operator (“IESO”) and the New Brunswick System Operator (“NBSO”) are not subject to the FERC’s jurisdiction or to penalties assessed by NERC.

members could be responsible for the underlying cause of a violation. In that case, they should be allocated an appropriate share of the costs of a penalty assessed against an ISO/RTO for a Reliability Standard Violation as the Registered Entity. However, third parties presently have no right to be a party to compliance proceedings, except if approved by FERC on a case-by-case basis. The IRC also notes that the reverse situation could arise where the actions of RTOs/ISOs could be responsible for the underlying cause of a violation when the RTO/ISO member is the Registered Entity. In that case, they could be allocated an appropriate share of the costs of a penalty assessed against an ISO/RTO member for a Reliability Standard Violation as the Registered Entity. Thus, the procedural rule deficiencies should also provide intervention rights for RTOs/ISOs in these scenarios.

At the October 20th meeting, we discussed how these inconsistencies may be resolved through revisions to the NERC penalty assessment procedures. More specifically, Mr. Cook suggested a process under which NERC and its Regional Entities would create and maintain a list of parties who may be financially responsible for the violation of Reliability Standard penalties assessed against the Registered Entity (i.e. an ISO/ISO or ISO/RTO members) under FERC approved tariffs or agreements. Given that NERC procedures and their consistency with a FERC order on penalty assessments is involved, the IRC once again recommends that NERC itself, through its officers, initiate proposed reforms for stakeholder discussion and review. The IRC stands ready to serve as a resource to NERC in this process. The IRC poses below some proposed revisions to NERC procedures to effectuate the FERC Orders discussed below consistent with our discussion at the October 20th meeting. In the interim until this matter is resolved, we will continue to indicate to affected stakeholders that they should seek intervention in NERC proceedings by so filing at FERC. We recognize NERC's desire to avoid this more cumbersome process and as a result, request your initiation of rule changes at NERC to resolve this matter through an amendment to the NERC intervention rules governing reliability investigations and penalty proceedings.

I. Issue Presented

FERC established a “road map” for allowing the allocation of the costs of reliability penalties assessed against an RTO/ISO in its Guidance Order concerning allocation of NERC penalties in the RTO context (*Reliability Standard Compliance and Enforcement in Regions with Regional Transmission Organizations or Independent System Operators*, 122 FERC ¶ 61,247 (March 20, 2008)). Subsequently, FERC provided further guidance in its September 18, 2008 ruling on a related PJM filing in Docket No. ER08-1144-000. *See PJM Interconnection, L.L.C.* 124 FERC ¶ 61,260 (September 18, 2008) (the “PJM Order”). Subsequently, SPP, NYISO, and MISO filed similar Reliability Standard penalty allocation rules under their respective tariffs.² The Guidance Order and the FERC-approved tariff language for the various ISOs and RTOs give an ISO/RTO the ability to “directly allocate penalty costs, or a portion thereof, to the Member(s)

²² *See New York Independent System Operator, Inc. Order Accepting Tariff Revisions* 127 FERC ¶ 61,169 (May 29, 2009); *South West Power Pool, Inc. Order Accepting Tariff Revisions* 126 FERC ¶ 61,061 (January 23, 2009); and *Midwest Independent Transmission System Operator, Inc. Order Conditionally Accepting Proposed Tariff Revisions*, 128 FERC ¶ 61,229 (September 8, 2009) (collectively referred to as the “ISO/RTO Orders”). ISO-NE and Cal ISO determined that their current pass through provisions and the process set out in the Guidance Order were sufficient and did not file for tariff modifications regarding reliability standard penalty allocation.

if their conduct contributed to the Reliability Standards violation(s)”, subject to certain conditions.

In the Guidance Order and ISO/RTO Orders, the Commission approved the direct allocation of penalties to entities that caused the reliability violation if certain conditions are met. One of those conditions is the due process rights of the target ISO/RTO member or the ISO/RTO receives notice and an opportunity to fully participate in the compliance enforcement proceeding conducted by NERC or NERC’s Regional Entities.³ It is this condition that drives the need for an amendment of the current procedural rules that bars third parties from becoming a party to compliance proceedings, except if approved by FERC. Without such an amendment, the goals and purposes behind the ISO/RTO tariff provisions allowing for the allocation of Reliability Standards penalty costs to the parties who are responsible for the underlying cause of a violation and FERC’s directives in the Guidance Order and the ISO/RTO Orders will be frustrated.

In the PJM Order, when approving PJM’s penalty allocation proposal, FERC clearly anticipated unregistered RTO members having to intervene in NERC compliance and enforcement proceedings when the member’s conduct may have caused PJM to be in violation of reliability standards. Specifically, P 41 of the order states as follows:

“The Guidance Order, however, continues, “[s]imilarly, 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 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 member and customers and/or in their tariffs. . . .” PJM proposes to do just that. As PJM stated in its Answer, an action under Schedule 11 is designed to be a “response to violation of [PJM’s] Governing Agreements,” in the sense that causing another entity to violate a NERC Reliability Standard is also a violation of PJM’s own rules about member relations and Good Utility Practice. By agreeing to PJM’s Operating Agreement, therefore, small unregistered parties have already conceded that they will make some effort to help maintain reliability within PJM. As we stated earlier, however, all Schedule 11 claims must come before the Commission as section 205 filings, and in accordance with our Guidance Order, we must review those filings on a case-by-case basis. Such

³ In the Guidance Order, the Commission stated: “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.³ 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.” *Guidance Order* at P 23.

unregistered entities will have the opportunity, if they so choose, to raise similar challenges before NERC during the Compliance Monitoring and Enforcement Program phase (emphasis added).”

Thus, there is a clear disconnect between the Commission’s findings in this and other orders and the NERC procedural rules which do not allow for non-registered entities to intervene in NERC proceedings. Therefore, the IRC proposes to amend section 1.2.12 the NERC’s Hearing Procedures intervention rules which currently state that *only* Respondents (defined as the Registered Entity only) and Staff shall be Participants in the Compliance Proceedings and, absent FERC authorization, no other parties, including RTO/ISO members, may be a Participant. As stated in January 23, 2009 Memorandum, clarification is needed concerning *the processes* to be utilized in investigations. The goal of such clarifications should be to: 1) ensure that procedures are clear enough to provide due process opportunities for entities that may be allocated a penalty under the FERC Orders outlined above; and 2) ensure that NERC and the Regional Entities have access to all the facts needed to ensure a thorough root cause investigation of the violation when necessary.⁴

To accomplish this goal, the IRC previously proposed a solution to this issue for NERC, with IRC support, to request for the FERC to allow for the addition of the following language to Section 1.2.12: “A Person whose underlying conduct may have given rise to the alleged Reliability Standards violation and who may be liable to the Registered Entity for any penalties that may be assessed against the Registered Entity by law, contract, tariff or regulation, shall be permitted to intervene as a Party to docket proceeding upon a preliminary showing of the appropriate nexus between the alleged violation and the Person's conduct. In addition, NERC or the Regional Entity may name such a Person as a Party to a proceeding *sua sponte*.”

The IRC believes that this is still an appropriate proposal worth consideration. The IRC, however, recognizes that the NERC does not want to be in the position to adjudicate case-by-case whether parties qualify for intervention. Therefore, Mr. Cook suggested another possible solution a process under which NERC and its Regional Entities would create and maintain a list of parties who may be financially responsible for the violation of Reliability Standard penalties assessed against the Registered Entity (*i.e.* an ISO/ISO or ISO/RTO members) under FERC approved tariffs or agreements. To accomplish this goal, the IRC offers the following alternative proposal for NERC to amend its procedural rules and file such amendment with FERC to allow for the addition of the following language to Section 1.2.12:

“The NERC shall maintain a List of Persons whose underlying conduct may have given rise to the alleged Reliability Standards violation and who may be liable to the Registered Entity for any penalties that may be assessed against the Registered Entity by law, contract, tariff or regulation, and shall permit such Person or Persons to intervene as a Party to a proceeding or investigation involving said Registered Entity. The NERC shall include any such Person on the List who upon an affirmation by such person and/or the Registered Entity affirming that : (i) such Person is obligated by law, contract, tariff or regulation to perform tasks or obligations for which the failure to perform may result in another Person who is a Registered Entity to be in

⁴ The IRC is not taking a position on whether procedures should provide NERC or the Regional Entity the ability to join a party to the investigation on its own motion however that issue should be addressed.

violation of Reliability Standards; and (ii) such Person may be financially responsible for the violation of Reliability Standard penalties assessed against the Registered Entity pursuant to FERC approved tariffs or agreements. In the event the NERC initiates a Compliance Violation Investigation or other proceeding and the facts demonstrate a nexus between the alleged violation and a Person's conduct and that Person is on the List, the NERC shall provide written notice to such Person immediately and permit such Person the right to intervene as a Party to such proceedings or Compliance Violation Investigation. Such Person shall be permitted to intervene in any such proceeding on its own motion provided such person is on the List. In addition, NERC or the Regional Entity may name such a Person as a Party to a proceeding *sua sponte*. Provided, however, the fact that any Person is on the NERC List shall not be an admission of liability or fault and shall not be evidence of culpability in any NERC Compliance Violation Investigation, proceeding, FERC proceeding or investigation or any other judicial or regulatory forum.”

The key point is that the blanket prohibition on third-party participation in these proceedings must be modified appropriately, and the IRC welcomes the support of NERC in seeking a further clarification of these hearing procedures before FERC.

II. Procedural Path

NERC’s Rules of Procedure “Amendments to the NERC Rules of Procedure”, Section 1401 states as follows: “In accordance with the bylaws of NERC, requests to amend or repeal the rules of procedure may be submitted by (1) any ten members of NERC, which number shall include members from at least three membership segments, (2) the Member Representatives Committee, (3) a standing committee of NERC to whose function and purpose the rule pertains, or (4) an officer of the ERO.” Pursuant to Section 1204, the procedural rule amendment request must be approved by the NERC Board of Trustees.

We believe the most expeditious way to achieve resolution of this matter would be for an officer of NERC to propose this change. We believe this is the appropriate path since David Cook first proposed this alternative to avoid parties seeking intervention through FERC in NERC proceedings. The IRC would stand with and support this change. We are asking for your initiation of such a change and hereby offer our full support and resources to ensure that this proposal is adopted. We request a response by July 7, 2010, as to your willingness to proceed in this manner. If NERC is unwilling or unable to proceed in that fashion, an alternative plan would be for the IRC to get ten members of NERC from at least three membership segments to submit the amendment proposal. That alternative may be more challenging and will take more time. As a result, we seek your support for an officer of NERC, with the support of the IRC, proposing this change.

III. Conclusion

We believe that NERC Compliance Monitoring and Enforcement Program and Hearing Procedures need to be revised to allow RTO/ISO market participants to fully participate in the Compliance Proceedings and the Hearing Proceedings when the actions of such members may be responsible for NERC penalties assessed against the RTO/ISO as the Registered Entity. It is

critical that as part of its determination that a Registered Entity violated NERC Reliability Standards, NERC and the Regional Entity look at all relevant entities in the root cause determination of fault. As described above, the current version of the relevant procedures is deficient in both respects.

Revisions to NERC procedures are necessary to capture the role of all relevant entities in the root cause of NERC standard violations, and to provide due process rights to entities implicated in such violations. These changes will enable an equitable allocation of costs to third parties where the circumstances dictate that result and avoid a failure to provide the appropriate behavioral incentives intended by the imposition of Reliability Standard penalties.

Accordingly, it is critical to revise the relevant NERC and Regional Entity procedures to avoid inequitable outcomes where irresponsible parties avoid penalties to the detriment of others. The changes proposed above, or similar ones, would facilitate appropriate outcomes under the new reliability paradigm. The IRC suggests that given the inconsistency of the present procedures with FERC's recent Orders on allocation of penalties, at least in the RTO context, that NERC and the IRC work together jointly to present to FERC an equitable resolution. The IRC stands ready to work with NERC in this endeavor. We offer the ISO/RTO Council Regulatory and Legislative Committee ("RLC") and the ISO/RTO Council Standards Review Committee as resources available to work with NERC on this important matter.

We thank you and your staff for your continued constructive work with us on this issue.



Memorandum

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Subject: NERC and Regional Reliability Entity Compliance Monitoring and Enforcement Procedures
Date: January 23, 2009
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As we discussed at our recent meeting, the ISO/RTO Council ("IRC") has been working with NERC, FERC and the Regional Entities to ensure that there is a fair and equitable means for RTOs and ISOs to allocate the cost of NERC penalties among RTO/ISO market participants, particularly in an instance where actions of a specific market participant, rather than the RTO/ISO, caused the penalty to be incurred. The IRC has raised this issue on a number of occasions to FERC both in the context of generic comments and in the context of RTO specific filings undertaken by Midwest ISO and PJM.

Discussions with FERC and recent Commission rulings reveal a deficiency in the NERC penalty assessment procedures (and potentially Regional Entities' procedures) that make them inconsistent with the applicable FERC Orders on allocation of penalties. As part of the IRC's assessment of the applicability of NERC penalties to the RTO markets, the IRC wishes to identify this deficiency to NERC and explain how it undermines the goal of properly charging the entity that NERC identifies as contributing to the root cause of the violation. We have begun discussions with David Cook on these issues and look forward to continuing dialogue with NERC on these important matters.

We believe that the NERC procedures concerning intervention rights in a penalty proceeding need to be harmonized with recent FERC Orders concerning allocation of penalties in an RTO context. The present inconsistency requires timely corrective reforms to the NERC penalty assessment procedures before the inconsistencies lead to litigation that could undermine the entire penalty assessment process at its early stage. Given that NERC procedures and their consistency with a FERC Order on penalty assessments is involved, the IRC recommends that NERC itself, through its officers, initiate proposed reforms for stakeholder discussion and review. The IRC stands ready to serve as a resource to NERC in this process. In the spirit of advancing this matter for consideration by NERC, the IRC poses below some proposed revisions to NERC procedures to effectuate the FERC Orders discussed below.¹

¹ The Independent System Operator operating as the Alberta Electric System Operator ("AESO"), Ontario Independent Electricity System Operator ("IESO") and the New Brunswick System Operator ("NBSO") are not subject to the Federal Energy Regulatory Commission's ("FERC") jurisdiction or to penalties assessed by NERC.

I. Issue Presented

What changes are needed to NERC and (potentially) Regional Entity Compliance Monitoring and Enforcement Procedures and Hearing Procedures to enable RTOs/ISOs who are Registered Entities, but rely on their members to perform certain Reliability Standards compliance tasks, to allocate the costs of NERC penalties as permitted by the Federal Energy Regulatory Commission's March 20, 2008 order in Docket No. AD07-12 ("Guidance Order")?

II. Discussion

FERC established a "road map" for allowing the allocation of the costs of reliability penalties assessed against an RTO/ISO in its Guidance Order concerning allocation of NERC penalties in the RTO context (*Reliability Standard Compliance and Enforcement in Regions with Regional Transmission Organizations or Independent System Operators*, 122 FERC ¶ 61,247 (March 20, 2008)). Subsequently, FERC provided further guidance in its September 18, 2008 ruling on a related PJM filing in Docket No. ER08-1144-000. *See PJM Interconnection, L.L.C.* 124 FERC ¶ 61,260 (September 18, 2008). The Guidance Order and the PJM Order give an RTO/ISO the ability to "directly allocate penalty costs, or a portion thereof, to the Member(s) if their conduct contributed to the Reliability Standards violation(s)", subject to certain conditions.

In the PJM Order (the first Order issued subsequent to the Commission's Guidance Order), the Commission approved the direct allocation of penalties to entities that caused the reliability violation if all three of the following conditions are met:

- The target market participant receives notice and an opportunity to fully participate in the Compliance Monitoring and Enforcement Program conducted by NERC or NERC's Regional Entities.
- The NERC Compliance Monitoring and Enforcement Program holds a proceeding that finds that the target Members at least in part "contributed ... to the NERC Reliability Standards violation(s)", and files this finding with the Commission.
- NERC also files a root cause filing with the Commission, "identifying the Member's or Members' conduct as causing or contributing to the Reliability Standards violation charged against PJM."

Through its Order, FERC made clear the need for NERC's Compliance Proceedings (and the Regional Entities' processes, if applicable) to provide an opportunity for an RTO's/ISO's members to fully participate in the Compliance Proceedings, *at every stage*, when such entities may be financially responsible for

reliability violation penalties assessed against an RTO/ISO as the Registered Entity. This is appropriate because the actions of RTO/ISO members could be responsible for the underlying cause of a violation. In that case, they should be allocated an appropriate share of the costs of a penalty assessed against an ISO/RTO for a Reliability Standard Violation as the Registered Entity. However, third parties presently have no right to be a party to compliance proceedings, except if approved by FERC on a case-by-case basis.

It is also critical for the Regional Entity and NERC to look at all relevant parties in conducting a root cause finding of fault as the independent entity overseeing reliability. As currently written, however, the Uniform Compliance Proceeding procedures adopted by NERC in compliance with FERC's directives, and largely relied upon by Regional Entities, **do not allow** for participation by third parties such as an RTO/ISO's members, and do not explicitly direct NERC and the Regional Entity to include root cause findings beyond the findings of non-compliance by Registered Entities. These problems are illustrated by the NERC Uniform Hearing Procedures, which, again, are largely used as a guide by many of the Regional Entities.

We understand that NERC's intervention rules were adopted in compliance with FERC's directives in Order No. 672. Also, we are mindful that in its recent ruling in Order No. 718, FERC declined to impose an absolute right of a party to intervene in a FERC enforcement proceeding. However, FERC did note that permissive intervention, based on the facts and circumstances, would be allowed. In the RTO context given the breadth of activities performed by an RTO, there could well be a circumstance where the RTO is assessed a penalty even though NERC determines the root cause of the violation to be the actions of another entity. The recent FERC Order in the PJM case allows PJM to assess a penalty against the culpable party in that instance. Although FERC left the door open for permissive intervention (and such a circumstance would be a prime example where permissive intervention is appropriate), FERC created an inconsistency when it directed NERC to adopt procedures which simply bar intervention in all instances, thereby forcing a party to petition FERC for permission to intervene at the NERC level. Such a cumbersome process can only work to delay and complicate investigations and remains at odds with ensuring adequate due process and timely completion of a thorough investigation of the root cause of an alleged reliability violation.

§ 1.1.1 Procedure Governed: As presently written, this section of the NERC Hearing Procedures focuses exclusively on whether the Registered Entity (e.g. the RTO) violated Reliability Standards. To remedy the procedural defects, the following language could be added to (i): “, and the underlying facts and circumstances leading to such violation including whether the conduct, actions or inactions of any other person or persons caused the Reliability Standards violation in question.”

§ 1.2.1 Contents of Filings: The present procedures concerning contents of filings are also lacking in detail in this area. To address this issue, Subpart (d) could be amended as follows: “A plain and concise statement of any facts upon which the filing is based, including, but not limited to, whether the conduct, actions or inactions of any other

person or persons caused the Reliability Standards violation in question, which facts shall be supported by citations to the record if available; and...” This change will help ensure that NERC and the Regional Entity conduct the necessary root cause findings.

§ 1.2.12 Interventions Are Not Permitted: This section of the Hearing Procedures is the most problematic for IRC members. It states that *only* Respondents (defined as the Registered Entity only) and Staff shall be Participants in the Compliance Proceedings and, absent FERC authorization, no other parties, including RTO/ISO members, may be a Participant.

In addition, clarification is needed concerning *the processes* to be utilized in investigations. The goal of such clarifications should be to: 1) ensure that procedures are clear enough to provide due process opportunities for entities that may be allocated a penalty under the FERC Orders outlined above; and 2) ensure that NERC and the Regional Entities have access to all the facts needed to ensure a thorough root cause investigation of the violation when necessary.²

At this stage, the IRC recognizes that the NERC Hearing Procedures are subject to FERC interpretations and were adopted to comply with FERC’s directives. One possible solution to the issues outlined above would be for NERC, with IRC support, to seek a clarification from FERC that would allow for the addition of the following language to Section 1.2.12: “A Person whose underlying conduct may have given rise to the alleged Reliability Standards violation and who may be liable to the Registered Entity for any penalties that may be assessed against the Registered Entity by law, contract, tariff or regulation, shall be permitted to intervene as a Party to docket proceeding upon a preliminary showing of the appropriate nexus between the alleged violation and the Person's conduct. In addition, NERC or the Regional Entity may name such a Person as a Party to a proceeding *sua sponte*.”

The key point is that the blanket prohibition on third-party participation in these proceedings must be modified appropriately, and the IRC welcomes the support of NERC in seeking a further clarification of these hearing procedures before FERC.

§ 1.3 Initiation of the Hearing Process: Similar to the issue above, the Hearing Process only appears to apply to Registered Entities. This section – and any comparable provisions of Registered Entities – should also be amended to broaden the scope of the Hearing Process to apply to third-parties as appropriate. This could be accomplished by replacing the term *Registered Entity* with the term *Party* throughout the section.

III. Conclusion

We believe that NERC Compliance Monitoring and Enforcement Program and Hearing Procedures need to be revised to allow RTO/ISO market participants to fully participate in the Compliance Proceedings and the Hearing Proceedings when the actions

² The IRC is not taking a position on whether procedures should provide NERC or the Regional Entity the ability to join a party to the investigation on its own motion however that issue should be addressed.

of such members may be responsible for NERC penalties assessed against the RTO/ISO as the Registered Entity. It is critical that as part of its determination that a Registered Entity violated NERC Reliability Standards, NERC and the Regional Entity look at all relevant entities in the root cause determination of fault. As described above, the current version of the relevant procedures is deficient in both respects.

Revisions to NERC procedures are necessary to capture the role of all relevant entities in the root cause of NERC standard violations, and to provide due process rights to entities implicated in such violations. These changes will enable an equitable allocation of costs to third parties where the circumstances dictate that result. Without such changes, ISOs/RTOs could be penalized for violations. Absent the ability to fairly apportion the costs, ISO's and RTO's only avenue to collect such costs would be socialization across all of its members. Aside from the obvious inequities, that result completely fails to provide the appropriate behavioral incentives intended by the imposition of reliability penalties.

Accordingly, it is critical to revise the relevant NERC and Regional Entity procedures to avoid inequitable outcomes where irresponsible parties avoid penalties to the detriment of others. The changes proposed above, or similar ones, would facilitate appropriate outcomes under the new reliability paradigm. The IRC suggests that given the inconsistency of the present procedures with FERC's recent Orders on allocation of penalties, at least in the RTO context, that NERC and the IRC work together jointly to present to FERC an equitable resolution. The IRC stands ready to work with NERC in this endeavor. We offer the ISO/RTO Council Regulatory and Legislative Committee ("RLC") and the ISO/RTO Council Standards Review Committee as resources available to work with NERC on this important matter.

We thank you and your staff for your continued constructive work with us on this issue.