

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards) **Docket No. RM05-30-000**
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COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

Pursuant to the Commission’s September 1, 2005 Notice of Proposed Rulemaking on *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards* (“NOPR”), the New York Independent System Operator, Inc. (“NYISO”) respectfully submits its comments in this proceeding. In addition to these comments, the NYISO also endorses, and is a signatory to, the comments that the ISO/RTO Council is separately filing today.¹

The NYISO commends the Commission for acting so quickly to comply with the reliability provisions in Subtitle A of the Electricity Modernization Act of 2005 (the “2005 Act”),² which established new Section 215 of the Federal Power Act (“FPA”). The NYISO has long favored the creation of a North American Electric Reliability Organization (“ERO”) and the transformation of existing Regional Reliability Councils into Regional Reliability Entities

¹ In particular, the NYISO adopts, and incorporates by reference, the ISO/RTO Council’s comments on respecting the technical expertise of regional entities that do not encompass entire interconnections, allowing regions smaller than interconnections to have reliability rules more stringent than the national standards, delegation agreements between the ERO and RREs, ERO funding mechanisms, the interaction between reliability standards and market rules, the undesirability of “scope and configuration” criteria for RREs, and the importance of ensuring that the ERO and RREs are not controlled by any individual stakeholder or stakeholder class.

² The Electricity Modernization Act of 2005 is set forth in Title XII of the Energy Policy Act of 2005.

(“RREs”). Most importantly, the NYISO has consistently supported the establishment of clear mandatory electric reliability standards, backed by effective sanctions, across North America. The NYISO is pleased that the Commission stands ready to exercise its new reliability authority and is confident that it will be used in a way that benefits all users of the bulk power system.

The NYISO and other Control Area operators, and market participants in the Northeastern United States and Eastern Canada that voluntarily signed the Northeast Power Coordinating Council (“NPCC”) agreement, are currently subject to mandatory reliability requirements developed by the NPCC. Moreover, the NYISO and all New York market participants are currently subject to mandatory reliability rules established by the New York State Reliability Council (“NYSRC”). Both the NPCC and NYSRC standards reflect the particular characteristics of power systems in the region and have a proven record of success. They have played a critical role in preserving regional reliability for years, although they could not, on their own, protect against problems arising outside of the NPCC that led to the widespread system outage of August, 2003. The 2005 Act will reinforce these arrangements by requiring all market participants in the NPCC region, and across North America, to comply with mandatory reliability rules for the first time.

New FPA Section 215 does not require radical changes to proven regional reliability standards and there is no reason for the Commission’s rules to do so. Indeed, because new FPA Section 215(h)(3) expressly authorizes New York State to continue to have reliability rules that are more stringent than the rest of the nation, it appears likely that, at the very least, the NYSRC’s rules will remain in effect. Nevertheless, the NYISO is concerned that the Commission may be unduly skeptical of some regions’ need for more rigorous standards, or even be inclined to discard them in favor of overly uniform national rules. For the reasons set forth

below, it would be a mistake to take this approach. A heavy burden of proof should be on those who would change or eliminate proven regional rules, not on those who would preserve them. Indeed, the ERO should be expected to file regional rules that are consistent with, but more stringent than, its own national standards, as a matter of course.³

In addition, the final rule should provide for effective, but flexible, sanctions to deter reliability violations. It should specify that not-for-profit system operators will only be subject to non-financial sanctions, because of the high likelihood that financial sanctions would drive them into insolvency.

Finally, the Commission should adopt confidentiality protections that prevent reliability investigations from disclosing sensitive information that might harm ISO/RTO markets.

I. THE NPCC'S EXISTING REGIONAL RELIABILITY RULES HAVE WORKED WELL AND ARE WORTHY OF THE COMMISSION'S CONTINUED SUPPORT

The NPCC has developed a body of reliability rules that have worked well for the Northeastern United States and Eastern Canada. It is important to recognize that these rules are substantially more stringent than both the national standards NERC has adopted in the past, and the reliability standards that it intends to propose in response to the 2005 Act. There are longstanding and legitimate reasons for these differences. These include: (i) the difficulty of building new transmission infrastructure in much of the region; (ii) the fact that the system configurations in much of the region require operators to run their systems closer to operating limits than is the case in other regions; and (iii) the region's past experience demonstrating its susceptibility to cascading outages and the need for more stringent rules to make the region more resistant to them.

³ As is noted below in Section V, the NYISO interprets the NOPR as excluding issues related to New York specific reliability rules from the scope of this proceeding.

Prior to the 2005 Act, each entity that opted to join the NPCC had to execute the NPCC Membership Agreement, which obliged it to comply with both NERC and NPCC standards. The new statute will enhance this system by converting it into a fully enforceable mandatory regime spanning all of North America. NPCC also runs a compliance program, supported by State and provincial government authority, that includes a regime of non-monetary sanctions. This system has worked well, as evidenced by the 100% rate of compliance with NPCC requirements in 2004, and the greater than 90% compliance rate in every year since 1999 (which is when the program went into effect).

By contrast, the 2005 Act does not require, or even encourage, the Commission to make major changes to the existing NPCC rules. There is no evidence that the NPCC's role has created problems or, in particular, that the NPCC contributed in any way to the major system outage in August 2003, which clearly originated outside of the NPCC region. In reality, the NPCC facilitated the region's rapid recovery in 2003 and has prevented many other outages.

There is thus no reason to discard existing NPCC rules and replace them with less stringent national standards in the name of "uniformity." Legislation that was intended to strengthen reliability should not be construed in a way that would weaken it in a sensitive region. While the 2005 Act requires that the Commission "defer" to RREs that encompass an entire interconnection,⁴ that does not mean that the Commission should not respect the technical expertise and local system knowledge of entities like the NPCC. The Commission should not draw the false conclusion that because interconnection-wide entities are entitled to deference, Congress intended it to disregard regional standards, such as those of the NPCC, that are

⁴ As was noted in the ISO/RTO Council comments, this does not mean that the Commission must passively accept standards developed by interconnection-sized regions, or by the ERO itself, without any critical review.

essential to system reliability. Nor should the Commission seek to undo critical reliability protections simply because they are only needed in a region that does not encompass an entire interconnection. Instead of insisting on excessive uniformity, the Commission should continue its policy of treating national standards as establishing minimum requirements, while allowing individual regions to develop, maintain, and enforce more stringent rules that meet reliability needs specific to their electric systems.⁵

The Commission's final rule should therefore require the ERO to file existing regional rules, including NPCC rules, that are more stringent than, and consistent with, the ERO's, without modification, absent a clear showing of why specific changes are necessary.⁶ Likewise, the Commission should indicate that it will approve proven regional rules that are more stringent than ERO standards absent some compelling cause for changing them. The ERO should also be required to file newly developed RRE rules that are more stringent than, but consistent with, its standards, without conducting an extensive review. If an individual RRE decides that its region needs more stringent rules that are consistent with ERO standards, there is no reason to allow other regions or interests, acting through the ERO, to override that decision. The fact that the 2005 Act requires RREs to either be independent or run by a balanced stakeholder board should

⁵ See *Policy Statement on Matters Related to Bulk Power Reliability*, 107 FERC ¶ 61,052 (2004) (“NERC reliability standards should represent a floor for grid operators and bulk system participants, not a ceiling.”); *order granting clarification*, 108 FERC ¶ 61,288 (clarifying that the Commission intended to recognize more than mere physical characteristics of the bulk power system as a basis for more stringent regional criteria).

⁶ As is noted below, the 2005 Act expressly provides that States may take actions to strengthen reliability beyond the level provided for by the ERO standards so long as they are consistent with those standards. It also allows New York State to have more stringent rules. It does not prohibit individual regions from having rules that are consistent with, but more stringent than, the national requirements.

alleviate any concerns that they might propose regional rules for discriminatory or unlawful reasons.

II. THE COMMISSION SHOULD IMPOSE FINANCIAL PENALTIES ON MARKET PARTICIPANTS TO DETER AND PUNISH SERIOUS VIOLATIONS OF RELIABILITY STANDARDS

The NOPR proposes a strong penalty regime to support mandatory Reliability Standards and asks a number of specific questions on penalty-related issues. Among other things it seeks comments on the need for and applicability of financial penalties, the recoverability of penalty costs, and the appropriateness of remedial actions that would prevent reliability violations from occurring.⁷

Financial sanctions are clearly an appropriate remedial tool that should be used to punish serious violations by market participants with the capacity to pay them. The NPCC's experience demonstrates that non-monetary sanctions can work well and suggests that they are likely to be sufficient against market participants across North America for most purposes. As a general matter, it will probably be appropriate for the Commission to turn first to non-monetary sanctions and to gradually escalate to financial sanctions for market participants that fail to respond. If, however, a market participant commits a serious violation that jeopardizes reliability, or even causes an outage, the immediate imposition of financial sanctions to the maximum extent that the law allows would be fully warranted. In any event, the Commission should avoid adopting rigid financial penalty schedules in favor of a flexible approach that would allow it to adjust penalties to suit the severity of the offense.

⁷ NOPR at PP 58-66, 68-71.

The Commission should also not hesitate to take forceful action to prevent reliability violations before they occur. As the NOPR suggests,⁸ it seems most likely that Commission action in this scenario will take the form of a compliance order, roughly equivalent to an injunction, rather than a monetary sanction.⁹ Pre-violation orders could be extremely useful tools. ISOs and RTOs will likely be in a position to help the Commission make effective use of them by identifying circumstances where such an order should be issued against a market participant.

III. THE COMMISSION SHOULD ONLY USE NON-FINANCIAL SANCTIONS AGAINST NOT-FOR-PROFIT ISOS AND RTOS

ISOs and RTOs have such broad reliability responsibilities that their potential exposure to financial sanctions for an alleged reliability violation could be very great. As not-for-profit, thinly capitalized entities, ISOs/RTOs have virtually no ability to pay financial sanctions out of their own resources. If an ISO/RTO were not allowed to recover penalty costs from its customers, it would face insolvency, which would disrupt its markets and could threaten reliability within its region. The NYISO submits that imposing a financial sanction on a not-for-profit ISO/RTO that lacks the ability to pay would cause irreparable harm and would be arbitrary and capricious within the meaning of the Administrative Procedure Act. Non-monetary sanctions are the only practical way to deter or punish violations by ISOs/RTOs without threatening their viability.

The Commission should have reasonable confidence, at least in the first instance, that ISO/RTO directors will seek to act in the public interest and will make necessary changes when

⁸ NOPR at P 71(10).

⁹ That said, there may be circumstances where *ex ante* monetary sanctions are appropriate and the Commission should not rule out their use entirely.

reliability problems are called to their attention. Not-for-profit ISOs/RTOs have no incentive to “game” reliability, and have no affiliated companies that would benefit from such stratagems. To the extent that ISOs/RTOs fail to correct problems, there are many possible non-monetary sanctions that the Commission could use to calibrate an appropriate response. The Commission could begin with informal investigations and move on to formal audits if warranted. As the NOPR suggests, the Commission could also station its staff at ISO/RTO offices so that they can directly oversee reliability performance if necessary. The Commission could issue remedial orders that would compel ISOs/RTOs to make needed improvements and require them to file status reports so that the Commission can monitor their progress. Finally, the Commission could, either separately or in connection with remedial orders, issue public reprimands or place offenders on public “watch lists” as a means of fostering improvements. These kinds of sanctions would be more effective against ISOs/RTOs than monetary penalties and would have fewer unintended consequences.

The Commission should also discourage the ERO and RREs from adopting rules that punish ISOs/RTOs for control area violations that are caused by market participants and which ISOs/RTOs have no ability to prevent. Under current practice, ISOs/RTOs that are control area operators are generally held responsible for all control area violations. Prior to the 2005 Act, this was not a major risk but it became one now that violations may be backed by financial sanctions. The ERO and RREs should be required to impose sanctions directly on the entities that commit violations, rather than on the ISO/RTO, which will generally lack any means of unilaterally forcing market participants in their regions to comply with reliability rules. To the extent that “regional” financial sanctions are nevertheless imposed on ISOs/RTOs, the Commission should allow them to pass the costs through. Preferably, the pass-through would go directly to the

actual violator(s) but if necessary the costs should be borne by all ISO/RTO customers, rather than by an ISO/RTO itself.

IV. THE COMMISSION'S RULES SHOULD PROTECT SENSITIVE MARKET INFORMATION DURING RELIABILITY INVESTIGATIONS

The NOPR seeks comment on confidentiality rules to protect proprietary market information during reliability investigations, asking specifically whether the types of protections used in other kinds of enforcement actions should be employed.¹⁰ In order to maintain the confidence of market participants that is essential to keep electric markets operating, strict confidentiality measures must be established to govern such investigations to avoid the disclosure of highly sensitive market information. Reliability investigations will necessarily entail close scrutiny of a market participant's behavior, and would provide the ERO or RRE with access to a significant amount of information that is normally afforded confidential treatment by ISOs/RTOs. Disclosing such market information earlier than is provided for under ISO/RTO rules would inevitably make ISO/RTO markets less efficient and could facilitate undesirable collusive bidding behavior. Individual market participants that are accused of violations would also be harmed by the release of their own sensitive competitive information, potentially to a degree that would be disproportionate to the severity of the alleged offense. This would be especially unfair in the case of participants that are ultimately found to be innocent of any violation. Accordingly, the Commission should follow the same strict procedures for protecting confidential information in the reliability context that it does for other kinds of enforcement actions.

¹⁰ NOPR at P 71(11).

Furthermore, the Commission should consider adopting special confidentiality rules for RREs that have stakeholder boards but conduct investigations that involve ISO/RTO markets. Even if such a board is balanced, allowing its stakeholder members to have access to confidential ISO/RTO information will inevitably raise serious competitive concerns. The best outcome would be to deny stakeholder directors access to this kind of information, which could instead be entrusted to professional RRE staffs. The next best alternative would be to adopt especially stringent confidentiality protections to ensure that stakeholder directors will not make inappropriate use of sensitive ISO/RTO market information.

V. THE NOPR PROPERLY EXCLUDES NEW FPA SECTION 215(i)(3) FROM THE SCOPE OF THIS PROCEEDING

The NOPR makes no mention of the “New York Savings Clause” contained in newly enacted FPA Section 215(i)(3). That provision recognizes the unique electrical characteristics and reliability needs of New York State by expressly authorizing it, alone among all of the States, to “establish rules that result in greater reliability” within New York, “as long as such action does not result in lesser reliability outside the State than that provided by the reliability standards.” The NYISO interprets the NOPR's omission of any reference to this provision as indicating that it is outside the scope of this proceeding.

