

133 FERC ¶ 61,190
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

North American Electric Reliability Corporation

Docket Nos. RR10-7-001
RR10-11-000

ORDER GRANTING REHEARING AND ACCEPTING FILING

(Issued December 1, 2010)

1. On August 6, 2010, the North American Electric Reliability Corporation (NERC), SERC Reliability Corporation (SERC), Florida Reliability Coordinating Council (FRCC), and Southwest Power Pool (SPP) (collectively, Movants), requested rehearing of the Commission's July 12, 2010 order.¹ In the July 12 Order, the Commission conditionally accepted two Compliance Monitoring and Enforcement Program Agreements and associated revised Delegation Agreements, subject to certain modifications relating to, *inter alia*, the treatment of penalty monies collected from FRCC and SPP in their role as registered entities. Movants seek rehearing of the Commission's direction regarding the treatment of penalty monies. In this order, the Commission grants rehearing and modifies direction given in the July 12 Order, as discussed below.

2. In addition, the Commission accepts the proposed changes to Section 9(j) and Section 5 of Exhibit E of the *pro forma* Delegation Agreement, which pertain to the treatment of penalty monies. The Commission addressed NERC's revised *pro forma* Delegation Agreement in an October 21, 2010 order, but stated that it would not act on Section 9(j) and Section 5 of Exhibit E until it acted in the related proceeding pertaining to the Movants' request for rehearing on the July 12 Order.²

¹ *North American Electric Reliability Corp.*, 132 FERC ¶ 61,024 (2010) (July 12 Order).

² *North American Electric Reliability Corp.*, 133 FERC ¶ 61,061 (2010) (October 21 Order).

I. Background

A. Section 215 of the Federal Power Act

3. On February 3, 2006, the Commission issued Order No. 672 to implement the requirements of section 215 of the Federal Power Act (FPA), pertaining to electric reliability.³ Among other things, Order No. 672 authorizes the Electric Reliability Organization (ERO) to delegate its authority to a Regional Entity applicant by filing a delegation agreement with the Commission.⁴ In its final rule, the Commission considered the appropriateness of a combined system operator serving as a Regional Entity.⁵ Recognizing that such an organization may have “an inherent conflict of interest,” the Commission determined that a combined system operator or regional reliability council may seek Regional Entity status, but to qualify as a Regional Entity, the entity must demonstrate “a very strong separation between the oversight and operations functions.”⁶

4. On April 4, 2006, NERC submitted an application seeking authorization to serve as the ERO. In its application, NERC submitted its proposed organizational documents and operating agreements, including a proposed *pro forma* delegation agreement. In July 2006, the Commission issued an order certifying NERC as the ERO but directing NERC to incorporate specific changes to its proposed *pro forma* delegation agreement.⁷ NERC subsequently amended its *pro forma* delegation agreement and requested authority, pursuant to FPA section 215(e)(4) and section 39.8 of the Commission’s regulations, to

³ *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, 114 FERC ¶ 61,104 (2006), *order on reh’g*, Order No. 672-A, 114 FERC ¶ 61,328 (2006).

⁴ *Id.* P 670-673.

⁵ *Id.* P 687.

⁶ *Id.* P 700.

⁷ *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062 (2006), *order on reh’g and compliance*, 117 FERC ¶ 61,126 (2006), *aff’d sub nom. Alcoa v. FERC*, 564 F.3d 1342 (D.C. Cir. 2009).

delegate certain of its functions to eight Regional Entities, including SERC, SPP, and FRCC. On April 19, 2007, the Commission conditionally approved the delegation agreements of the eight Regional Entities.⁸

B. Compliance Monitoring and Enforcement Agreements

5. On March 10, 2010, NERC filed a petition requesting approval of two Compliance Monitoring and Enforcement Program Agreements (CMEP Agreements). These agreements, formed between SERC and SPP (SERC-SPP Agreement), and between SERC and FRCC (SERC-FRCC Agreement), provided that SERC will act as the Compliance Enforcement Authority for compliance matters involving all registered entity functions for FRCC and SPP within their respective regions. In its petition, NERC also requested approval of amendments to the Regional Entity Delegation Agreements of FRCC, SERC, and SPP, which were modified to reflect the CMEP Agreements.

6. As noted in the July 12 Order, Sections 2(d) and 5 of the proposed CMEP Agreements address the method of compensation for SERC acting as the Compliance Enforcement Authority. Section 2(d) obligates FRCC and SPP to reimburse SERC for the actual, reasonable costs of SERC's performance of the CMEP with respect to the FRCC and SPP registered functions, and requires that such reimbursement include an appropriate allocation of SERC's general and administrative costs. Section 5 of the SERC-FRCC Agreement states that, for 2010, FRCC agrees to compensate SERC \$5,000 per quarter, to be pro-rated for any partial quarter. Section 5 of the SERC-SPP Agreement provides that SPP agrees to pay SERC a fixed compensation amount of \$40,000 for the remainder of 2010. Section 5 further provides that, in its annual business plan and budget for 2011 and each subsequent year, SERC shall identify that portion of its CMEP budget that is attributable to the performance of the CMEP with respect to FRCC and SPP registered functions.

7. In addition, Section 3 of the proposed CMEP Agreements addressed the disposition of any penalty monies collected from FRCC and SPP as a function of SERC's CMEP activities. Specifically, the agreements provided that any penalties paid by FRCC or SPP for Reliability Standards violations by a FRCC or SPP registered function, shall

⁸ *North American Electric Reliability Corp.*, 119 FERC ¶ 61,060 (2007), *order on reh'g*, 120 FERC ¶ 61,260 (2007). In conditionally approving the delegation agreements, the Commission expressed concern over the potential for a conflict of interest in a situation where a Regional Entity that also has registered entity functions is responsible for monitoring its own compliance as a registered entity. The Commission therefore directed NERC to assume the expanded compliance oversight role itself, or find an alternative entity capable of enforcing compliance in these circumstances.

reduce that portion of the FRCC ERO or SPP RE ERO assessment paid by load-serving entities and designees in the FRCC or SPP region for the subsequent fiscal year.

8. In the July 12 Order, the Commission conditionally accepted the CMEP Agreements and Regional Entity Delegation Agreements, subject to NERC submitting a compliance filing addressing certain modifications to address several Commission concerns. One such required modification concerned Section 3, addressing the disposition of monetary penalties assessed against FRCC or SPP in their role as a registered entity. Specifically, the Commission rejected the proposal that penalties paid by either FRCC or SPP be treated as an offset against the funding requirements of either the FRCC or SPP Regional Entity, respectively. Instead, the Commission directed a modification of the proposed CMEP Agreements to provide that penalties assessed against FRCC or SPP should be paid to SERC and used to offset SERC's statutory budget.⁹

9. The Commission explained in the July 12 Order that NERC's proposal to allow penalty monies collected from FRCC or SPP to offset the funding requirements of the respective regions was not consistent with prior Commission decisions. Specifically, the Commission has held that monies from any penalties levied against a registered entity that is also a Regional Entity may not be used to offset the funding of that region, and that the investigating entity should receive any penalty monies resulting from its properly conducted compliance investigations.¹⁰

C. Revised Pro Forma Delegation Agreement (Docket No. RR10-11-000)

10. On October 21, 2010, the Commission issued an order addressing proposed revisions to the *pro forma* Delegation Agreement.¹¹ NERC proposed, *inter alia*, revisions to Section 9(j) and Section 5 of Exhibit E (Funding) of the *pro forma* Delegation Agreement, which address the allocation of penalty money assessed by a Regional Entity. These clauses provide that, generally, a Regional Entity shall use any penalty monies received as an offset against its next year's annual budget. In addition, Section 5 of Exhibit E provides:

Except as otherwise approved by the Commission, all penalty monies received by [Regional Entity], other than penalty monies received from an operational function or division or affiliated entity of [Regional Entity],

⁹ July 12 Order, 132 FERC ¶ 61,024 at P 25.

¹⁰ *Id.* (citing Order No. 672, 114 FERC ¶ 61,104 at P 626.)

¹¹ October 21 Order, 133 FERC ¶ 61,061.

shall be applied as a general offset to [Regional Entity]'s budget requirements for U.S.-related activities under this Agreement for the subsequent fiscal year. Funds from financial penalties shall not be directly applied to any program maintained by the investigating entity. Except as otherwise approved by the Commission, any penalty monies received from an operational function or division or affiliated entity of [Regional Entity] shall be transmitted to or retained by NERC and shall be used by NERC as a general offset to NERC's budget for its activities as the ERO under the Act for the following year.

In the October 21 Order, the Commission deferred action on proposed Section 9(j) and Section 5 of Exhibit E, explaining that, to ensure consistency, the Commission would address these provisions when acting on the request for rehearing in Docket No. RR10-11-000.¹²

II. Request for Rehearing

11. Movants request rehearing of the Commission's determination in the July 12 Order that penalties assessed against FRCC or SPP should be paid to SERC and used to offset SERC's statutory budget. Instead, Movants request that the Commission direct the modification of the CMEP Agreements and relevant Regional Entity Delegation Agreements to provide that penalties assessed against FRCC or SPP shall be paid to NERC and used to offset NERC's statutory budget.

12. The Movants offer four reasons in support of their request that the Commission direct an alternative disposition of penalty monies from that which was directed in the July 12 Order. First, Movants assert that requiring penalty monies to be paid to NERC and used to offset its statutory budget would be consistent with the disposition of penalties as originally discussed by the Commission in Order No. 672.¹³

13. Second, Movants state that use of the penalty monies in the manner directed in the July 12 Order could convey an unwarranted "windfall" benefit on the load-serving entities (LSE) in the SERC Region to the extent that potentially substantial penalty payments would result in equally substantial reductions in the assessments paid by LSEs in that region. Movants note that the proposed CMEP Agreements obligate FRCC and SPP to reimburse SERC for the actual, reasonable costs of SERC's performance of the CMEP Agreements with respect to the FRCC and SPP registered functions. Such reimbursement under the proposed CMEP Agreements includes an allocation of SERC's

¹² See *id.* P 29 n.19.

¹³ Request for Rehearing at 5 (citing Order No. 672, 114 FERC ¶ 61,104 at P 626).

general and administrative expenses. Movants state that the provisions of the proposed CMEP “protect the LSEs in the SERC Region from bearing the costs incurred by SERC to perform the CMEP responsibilities with respect to the FRCC and SPP, Inc. registered entity functions.”¹⁴ In addition, Movants assert that “allowing penalty monies to be paid to NERC and used to offset its statutory budget would more equitably spread the assessment-reducing benefit of the penalties across the assessments paid by all LSEs in the United States that fund NERC’s statutory activities.”¹⁵

14. Third, Movants state that directing penalties incurred by FRCC and SPP to be paid to NERC to be used to offset NERC’s statutory budget would be consistent with the current CMEP arrangement between NERC and the Western Electricity Coordinating Council (WECC) pursuant to which penalties incurred by WECC are paid to NERC and used to offset NERC’s statutory budget.

15. Finally, Movants assert that their request to allow penalties incurred by FRCC and SPP in their registered entity functions to be paid to NERC and used to offset NERC’s statutory budget “will allow for a uniform, *pro forma* approach to the treatment of all penalties incurred and paid by a Regional Entity or its affiliate, acting as a registered entity, for noncompliance with an applicable reliability standard.”¹⁶ Movants argue that their proposal would be consistent with Section 9(j) and Section 5 of Exhibit E of the revised *pro forma* Delegation Agreement that was negotiated by NERC and the Regional Entities, and proposed in Docket No. RR10-11-000.

III. Commission Determination

16. The Commission grants the request for rehearing. NERC should submit a compliance filing consistent with this determination by January 10, 2011.¹⁷ In addition, the Commission accepts Section 9(j) and Section 5 of Exhibit E of the revised *pro forma* agreement concerning the treatment of penalty monies received from a Regional Entity

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 6.

¹⁷ On August 6, 2010, NERC also filed a *Motion for Modification of Date for Compliance Filing* in Docket No. RR10-7-000. On August 12, 2010, we issued a Notice of Extension of Time granting an extension of time to comply with the July 12 Order up to and including January 10, 2011.

for violations as a registered entity. Specifically, the Commission accepts the proposed changes to Section 9(j) and Section 5 of Exhibit E of the *pro forma* Delegation Agreement.

A. Request for Rehearing

17. The Commission has stated that “in a situation where a monetary penalty is assessed against the operational side of [a Regional Entity], it is inappropriate for the Regional Entity to receive the penalty money as an offset against its next-year budget. We are concerned that allowing the Regional Entity to retain the penalty money would merely result in an accounting transfer from one division of the umbrella organization to another.”¹⁸ Based on this concern, the Commission directed in the July 12 Order that NERC submit a compliance filing that would revise the two CMEP agreements so that penalties assessed against the divisions of SPP and FRCC that perform operational functions as registered entities will not revert to SPP and FRCC as Regional Entities. The Commission directed that SERC receive such penalty monies. However, the Movants’ proposal that NERC receive the penalty money in such circumstances also reasonably resolves our concern that penalty monies not revert to a Regional Entity against whom a penalty is assessed

18. The Commission stated in Order No. 672 that “it is appropriate for the entity investigating an alleged violation and imposing a penalty to receive any penalty monies that result from that investigation.”¹⁹ Consistent with this statement, the Commission directed in the July 12 Order that SERC, as the Compliance Enforcement Authority under the CMEP Agreements, receive any monetary penalties that result from a SERC audit or investigation of SPP or FRCC operational activities. We continue to believe that the policy set forth in Order No. 672 should apply as a general matter. In particular, a Regional Entity that investigates non-compliance within its region should receive the monetary penalties assessed as a result of its investigation.

19. However, we find that an exception to this policy is warranted in the limited circumstances at issue in this proceeding, namely when Regional Entity compliance oversight results in the assessment of a monetary penalty against the operational division of another Regional Entity. As explained by the Movants, the proposed CMEP Agreements obligate FRCC and SPP to compensate SERC for its reasonable costs. Thus, the LSEs located in the SERC region are protected from assessments related to SERC’s compliance activity vis-à-vis SPP and FRCC. In this situation, SERC’s retention of

¹⁸ July 12 Order, 132 FERC ¶ 61,024, at P 25 (2010) (quoting *North American Electric Reliability Corp.*, 119 FERC ¶ 61,060, at P 228).

¹⁹ Order No. 672, 114 FERC ¶ 61,104 at P 626.

penalty monies above the cost of SERC's compliance activities would represent a "windfall" to SERC and the end users responsible for funding SERC. This situation has the potential to upset the otherwise equitable balance among the Regional Entities. In contrast, as noted by Movants, requiring penalty monies collected from a Regional Entity for violations of its actions as a registered entity to be paid to NERC and used to reduce NERC's statutory budget will more equitably spread the benefit of the penalties across the assessments paid by all LSEs. Further, it is noteworthy that all of the parties to the CMEP Agreements, NERC, SERC, SPP and FRCC, agree that NERC should receive any penalty money assessed pursuant to the CMEP Agreements.

20. Based on these considerations, the Commission grants rehearing and accepts the Movants' request to amend the CMEP Agreements and the relevant provisions of the Delegation Agreements between NERC and FRCC and NERC and SPP to provide that any penalties assessed against FRCC or SPP, as a registered entity, will be paid to NERC and used to offset NERC's statutory budget as the ERO.

B. Pro Forma Delegation Agreement

21. We accept proposed Section 9(j) and Section 5 of Exhibit E of the *pro forma* Delegation Agreement based upon similar considerations. We note that the proposed changes to Section 9(j) and Section 5 of Exhibit E of the *pro forma* Delegation Agreement will result in a uniform application of penalty monies across the eight Regional Entities in the scenario at issue here. Further, these provisions will assure that no single Regional Entity will receive a windfall compared to other Regional Entities when conducting compliance activities on behalf of another Regional Entity. In addition, with regard to the revised *pro forma* Delegation Agreement negotiated by NERC and the eight Regional Entities, all interested parties agree with the proposed treatment of penalty monies.

22. Accordingly, the Commission accepts Section 9(j) and Section 5 of Exhibit E of the *pro forma* Delegation Agreement.

The Commission orders:

(A) The request for rehearing is hereby granted, as discussed in the body of this order.

(B) NERC is hereby directed to submit a compliance filing by January 10, 2011, with amended CMEP Agreements and Regional Entity Delegation Agreements, as discussed in the body of this order.

(C) Section 9(j) and Section 5 of Exhibit E of the *pro forma* Delegation Agreement are hereby accepted, to become effective on the date of the issuance of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.