

Testimony of John S. Moot
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Mr. Chairman and Members of the Committee:

Thank you for this opportunity to appear before you to discuss the Federal Energy Regulatory Commission's progress in implementing the electric reliability provisions of the Energy Policy Act of 2005 (EPAcT 2005), provisions that will bring about historic changes in this country's electric utility industry and that represent a major contribution by Congress to the public welfare. I appear today as a Commission staff witness and do not represent the views of the Commission or any individual Commissioner.

Nevertheless, I am confident that I speak for everyone at the Commission when I say that we consider electric system reliability to be a matter of the highest priority. Indeed, Commission Chairman Joseph Kelliher has stated that "[a]ssuring reliability of the bulk power system is arguably the most important responsibility given the Commission by the Energy Policy Act of 2005."

I am happy to report that the Commission has met the deadline Congress established in EPAcT 2005 for issuing rules governing the certification of an electric reliability organization (ERO) and procedures for establishing, approving and enforcing electric reliability standards. The Commission currently has before it an application by the North American Electric Reliability Council (NERC) requesting certification as the ERO, as well as a request by NERC for approval of 102 reliability standards. Once the Commission processes these filings and the regional delegation agreements that will be

filed in the near future, we will have established the first-ever mandatory reliability regime for the nation's bulk-power system.

Congress initiated this process in EPAct 2005 when it amended the Federal Power Act (FPA) to include a new section designated section 215. It establishes a program of mandatory, enforceable electric bulk-power system reliability standards that are subject to Commission approval and are applicable to all users, owners, and operators of the nation's bulk-power system. Section 215 of the FPA requires the Commission to certify an ERO which will develop and administer reliability standards, subject to Commission review and approval. The ERO is authorized to impose, after notice and opportunity for a hearing, penalties for violations of reliability standards, subject to Commission review. In addition to enforcement by the ERO, the Commission may initiate enforcement on its own motion. Section 215 directed the Commission to issue a final rule implementing its requirements no later than 180 days after enactment, or by February 5, 2006.

The Commission issued a notice of proposed rulemaking (NOPR) on September 1, 2005 that contained proposed regulations concerning ERO certification, the process for developing and enforcing reliability standards, delegation of ERO authority to regional reliability entities, ERO funding and other matters necessary to implement FPA section 215. The Commission received approximately 1,700 pages of comments on the NOPR and made a number of changes to its proposed regulations based on these comments. On February 3, 2006 the Commission issued its final rule, which has been designated Order No. 672.

The regulations adopted by Order No. 672 establish:

- criteria that an entity must satisfy to qualify as the ERO;
- procedures for the ERO to propose new or modified reliability standards for Commission review;
- procedures for timely resolution of any conflict between a reliability standard and a Commission-approved tariff or order;
- procedures for resolving an inconsistency between a state action and a reliability standard;
- regulations pertaining to ERO funding;
- procedures governing an enforcement action by the ERO, regional entity or the Commission;
- criteria for delegating ERO authority to regional entities;
- regulations governing the issuance by the ERO of periodic reports assessing the reliability and adequacy of the North American bulk-power system; and
- procedures for creating regional advisory bodies composed of representatives of state governments and formed to advise the Commission, the ERO or regional entities on reliability matters.

On March 30, 2006, the Commission issued an order on rehearing in which it clarified certain aspects of the regulations issued in Order No. 672. The Commission received no comments on this order, and the rulemaking process initiated on September 1, 2005 is now complete.

As required by FPA section 215, the Commission's new regulations specify that the ERO must submit each proposed reliability standard, and any modification to an existing standard, to the Commission for approval. Only reliability standards approved by the Commission are enforceable under FPA section 215. The Commission may

approve a proposed reliability standard if it determines the standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest. The regulations allow regional entities to propose reliability standards through the ERO, and they allow the ERO to delegate compliance monitoring and enforcement to regional entities.

The ERO and regional entities must monitor compliance with the reliability standards. They may direct violators to comply with the standards or impose penalties for violations, subject to review by, and appeal to, the Commission. Under the Commission's new regulations, the ERO and regional entities will be subject to periodic performance assessments to assure that they remain in compliance with the requirements of the statute and the Commission's regulations. This will entail a performance assessment three years after certification and every five years thereafter.

The Commission's new regulations permit the ERO and regional entities to take remedial action other than through penalties, e.g., compliance directives or imposition of additional training requirements, and require them to have an audit program to ensure compliance. The regulations require the ERO to notify the Commission promptly of any violation, or alleged violation, of a standard and to propose penalty guidelines and a range of monetary and non-monetary penalties for violations. Non-monetary penalties can include such things as imposing a limitation on an activity, function, or operation, or adding an entity to a reliability watch list composed of major violators.

Our goal is to implement these new regulations as quickly as possible, consistent with due process and the deliberation necessary to assure that all legal and technical requirements have been met. The formal implementation process began on April 4, 2006.

On that date NERC filed an application for certification as the ERO and a petition seeking approval of its current voluntary reliability standards as the mandatory standards specified in FPA section 215. The Commission received no other requests for ERO certification or standards approval.

NERC was formed in 1968 by the regional reliability councils covering the contiguous 48 states, several provinces in Canada and a portion of Baja California Norte in Mexico. NERC and these (now) eight councils operate as a voluntary, industry-sponsored reliability organization formed to ensure the reliability of the North American bulk-power system. NERC's ERO certification application contains a detailed discussion of its capabilities, structure, rules, procedures and plans for transition to ERO status. The Commission issued a notice of this application on April 7, 2006. The Commission received comments on NERC's ERO certification application from over forty parties. Their comments generally support the application, but many offer recommendations on a host of matters pertaining to governance and balanced decision-making, the scope of the activities and functions NERC proposes, ERO funding, the reliability standard development process, reliability monitoring and standards enforcement, and delegation of the ERO's authority to regional entities. For example, several commenters address the range of users, owners and operators of the bulk-power system to be listed on a compliance registry that would be subject to possible reliability standard enforcement actions. Commission staff is currently reviewing these comments.

NERC's reliability standards petition seeks approval of 102 proposed reliability standards. Ninety of these standards, known as "Version 0" standards, became effective

on a voluntary basis on April 1, 2005. NERC explained that the Version 0 standards “are a translation, with certain improvements, of [its] operating policies that were developed over several decades and its planning standards, which were approved in September 1997.” The April 4, 2006 petition includes 12 new standards, which were approved by the NERC board of trustees for implementation in February 2006. NERC states that one additional standard, related to cyber security, is undergoing revision and was filed for informational purposes only. NERC maintains that the 102 proposed reliability standards collectively define overall acceptable performance with regard to operation, planning and design of the North American bulk-power system. NERC requests that the reliability standards become effective on January 1, 2007, or an alternative date determined by the Commission.

On April 18, 2006, the Commission issued a notice of a rulemaking process for consideration of NERC’s proposed reliability standards. Commission staff issued a preliminary assessment of the standards last week. In anticipation of NERC’s ERO certification application, Chairman Kelliher directed the Commission’s Division of Reliability in the Fall of 2005 to initiate a thorough technical review of NERC’s existing voluntary standards. Staff has been at work analyzing the standards for a number of months, and the document reflects its assessment to date. The preliminary assessment is approximately 130 pages long, and as one might expect, much of it is highly technical and directed primarily to an audience of power system operators and engineers. I can, however, summarize its basic conclusions in brief.

The assessment is limited to a technical review, and it makes no final

recommendations about whether NERC's proposed reliability standards satisfy the Commission's criteria for acceptable standards. It is the first step in an open and inclusive process designed to solicit industry comment on the potential deficiencies in the current standards and the appropriate process and timeline for addressing them. Staff concluded that NERC's voluntary standards program represents a solid foundation on which to maintain and improve the reliability of the nation's bulk-power system. However, staff also identified a number of deficiencies, many of which, it should be noted, NERC itself has acknowledged. For example, some of the proposed standards contain ambiguities that need to be clarified. There are instances of technical inadequacy that raise concerns. Some standards lack objective measures and compliance levels that are necessary for consistent interpretation and enforcement. This list of examples is representative rather than exhaustive.

I do not wish to leave the impression that the problems staff has identified represent insurmountable difficulties. As noted, staff concluded that NERC's proposed standards constitute a solid foundation from which to proceed. However, the Commission believes that Congress intended it to promote improvements in bulk-power system reliability, and pursuing that goal makes it necessary to take a hard look at the existing standards to determine whether any require modification to meet the statutory standard.

The Commission stated in its April 18, 2006 notice that it intends to hold a technical conference on the NERC standards prior to issuing a formal notice of proposed rulemaking. This technical conference, and an opportunity for subsequent written

comments, will provide the public with an opportunity to comment on both NERC's proposed standards and Commission staff's assessment of those standards. The Commission anticipates that this preliminary analysis, and the exchange of ideas it will promote, will help to focus and expedite the formal rulemaking process.

The Commission's regulations incorporate the statutory requirement that to be approved the Commission must determine that a reliability standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest. The regulations also specify that the Commission will remand for further consideration a proposed reliability standard that it determines fails to satisfy this test in whole or in part. The Commission anticipates that the task of standards review and approval will be an ongoing process and will continue even after an initial set of reliability standards has been approved. As facts and circumstances change, and as our understanding of the bulk-power system grows, new standards, or improvements to existing standards, will become necessary. The Commission's regulations take this into account and specifically provide that the Commission may, on its own motion or a complaint, order the ERO to submit a new or modified standard when the Commission considers this appropriate to carry out the requirements of FPA section 215.

I would like to turn now to a general description of some of the key issues that the Commission expects to address in the coming months as it proceeds to certify an ERO and approve an initial set of mandatory reliability standards.

As part of its review of NERC's ERO certification application, the Commission will need to consider the details of how the ERO will operate, including matters related to

compliance oversight, enforcement of standards and assessment of penalties. Section 215(c) of the FPA specifies that before an entity can be certified as the ERO, the Commission must determine that the entity has rules that, among other things, (i) assure its independence from users, owners and operators of the bulk-power system; (ii) equitably allocate reasonable dues, fees and other charges among system end users; (iii) provide fair and impartial standards enforcement procedures; and (iv) provide for reasonable notice and opportunity for comment, due process, openness, and balance of interests in developing reliability standards and otherwise exercising its duties. The Commission received numerous comments addressing some of these matters in the rulemaking that led up to the issuance of Order No. 672. In many cases the Commission concluded that the issues raised would be best dealt with in the context of ERO certification. Staff's initial review of the comments received on NERC's certification application indicates that public interest in these issues remains high.

The Commission will need to consider the establishment of regional reliability entities. The statute permits the ERO, with Commission approval, to delegate the authority to enforce reliability standards to regional entities. NERC's ERO certification application contains a pro forma delegation agreement that sets out elements that would be common to every such agreement. Individual agreements may include other elements based on matters specific to the region in question. While the Commission stressed the importance of uniformity among regional entities in Order No. 672, a certain amount of variation is likely based on regional differences and unique features of specific systems. The Commission will have to evaluate that variation on a case-by-case basis when

reviewing individual delegation agreements submitted for approval.

A related issue that the Commission will need to resolve is the degree of uniformity necessary for enforcement, due process and penalty assessment across the regional entities. The Commission stated in Order No. 672 that it believes regional processes should be uniform unless regional facts, other than custom, require a difference. The Commission will need to evaluate any region-specific procedures or process standards contained in a proposed delegation agreement in light of this basic policy.

The Commission will need to devote considerable attention to reviewing NERC's 102 proposed reliability standards. As noted above, Commission staff has been engaged for some time now in a detailed technical analysis of the proposed standards and has issued a comprehensive assessment of them. The Commission will continue its analysis and expects that the process will enter a new stage once public comment on the standards is received both in the technical conference and the subsequent rulemaking proceeding.

In addition to detailed analysis of individual reliability standards, the Commission will need to consider its procedural options under section 215. The Commission could accept the standards, remand them for further development, or accept them on the condition that they are modified to address certain concerns. The Commission also must determine whether there are groups of standards that must be accepted or remanded as a package because the effectiveness or enforceability of one depends on the approval of others in the same group.

In the course of reviewing and approving reliability standards, the Commission

will need to consider any proposed regional variations in standards. The Commission concluded in Order No. 672 that uniformity of reliability standards “should be the goal and the practice, the rule rather than the exception.” At the same time, it noted two types of regional variations that generally would be acceptable: (i) regional differences that are more stringent than the continent-wide standard and (ii) a regional standard that is necessitated by a physical difference in the bulk-power system. In addition to considering such variations, the Commission will need to deal with the problem of transition to greater uniformity. The Commission has acknowledged that the transition cannot be made overnight, but it will be necessary to ensure that reasonable progress toward uniformity is achieved.

FPA section 215 also allows for the creation of regional advisory bodies. These bodies will advise both the ERO and the Commission on a range of matters related to reliability. The Commission has already received a petition from the Western Governors Association requesting that the Commission establish a proposed Western Interconnection Regional Advisory Body. In addition to representatives from the states concerned, that organization is expected to include members representing the Canadian provinces of Alberta and British Columbia and the Mexican state of Baja Norte or an agency of the government of Mexico representing the portion of Mexico in the Western Interconnection.

The Commission also will need to work directly with regulators from Canada and Mexico to ensure successful implementation of mandatory reliability standards. The North American transmission grid is an interconnected continental system regulated by

the laws of three nations. However, it operates according to the laws of physics, which do not respect national boundaries. In order to ensure transmission grid reliability, the Commission will need to continue to cooperate with both Canada and Mexico.

New FPA section 215(c)(2)(E) requires the ERO to take appropriate steps to gain recognition in Canada and Mexico. NERC has already begun seeking recognition from governmental authorities in Canada. NERC is also in discussions with Mexican authorities, although I understand that at this time the electric system regulator in Mexico may not have comparable reliability authority. Together with the Department of Energy and in coordination with the State Department, the Commission has been working closely with Canadian federal and provincial authorities for some time, and has been in contact with Mexican regulators, to coordinate implementation of this new law.

Finally, the Commission still must answer several fundamental questions arising under FPA section 215 either through additional rulemakings or on a case-by-case basis. Of particular importance is the issue of determining who is considered a “user” of the bulk-power system for purposes of section 215. The statute itself does not settle this question, but rather simply states that all users, owners, and operators of the bulk-power system shall comply with the new reliability standards. The Commission determined in Order No. 672 that who is to be deemed a user would be best considered in the context of its review of proposed reliability standards.

The Commission is well positioned to undertake all of these tasks. In fact, it began to focus on reliability issues well before the passage of EPAct 2005. Commission staff played a key role in the U.S.-Canada Power System Outage Task Force formed to

investigate the August 14, 2003 blackout. When the Task Force issued its report in April 2004, the Commission took immediate steps to implement the recommendations contained in it that were addressed to the Commission. Among other things, it announced that no new independent system operator or regional transmission organization would be approved until its reliability capabilities were functional. The Commission also issued a policy statement in response to the Blackout Report that addressed a number of other issues, such as cost recovery of prudent reliability expenditures, the need to cooperate with the states, Canada and Mexico on reliability issues, and the interpretation of reliability-related provisions in transmission tariffs on file with the Commission. On this last point, the Commission stated that requirements in those tariffs to follow “good utility practice” would be interpreted to include compliance with NERC’s reliability standards.

The Commission helped form the Bilateral ERO Oversight Group in February of 2004 to develop an international framework for electric reliability. The Group is comprised of representatives from the Commission, the U.S. Department of Energy, the Federal-Provincial-Territorial Electricity Working Group in Canada, with assistance from the Canadian Department of Foreign Affairs and International Trade, and the U.S. Department of State. In October of 2004 the Commission established a new Division of Reliability to develop policies, programs and strategies to promote and facilitate reliability. It also added staff with expertise in reliability matters. The Commission is currently in the process of expanding its reliability staff even further. One task of this new division has been to participate in NERC’s reliability readiness reviews of balancing

authorities, transmission operators and reliability coordinators in North America to determine their readiness to maintain safe and reliable operations. It also has been engaged in studies and other activities to assess longer-term and strategic needs and issues related to power grid reliability.

In conclusion, I can say that the Commission is hard at work implementing the electric reliability provisions of EPCRA 2005 as Congress intended, as expeditiously as possible, and in light of input from all affected industry stakeholder groups. Thank you again for this opportunity to speak, and I will be happy to answer any questions you may have.