Thu, 08 Jan 1998

Dr. Walter Massey
Chairman, Secretary of Energy Advisory Board
c/o Morehouse College
830 Westview Drive, S.W.
Atlanta Georgia 30314

Dear Dr. Massey:

The Task Force on Electric System Reliability of the Secretary of Energy Advisory Board is writing to provide you with our Task Force Paper entitled Maintaining Bulk-Power Reliability Through Use of a Self-Regulating Organization. This Paper was approved by the Task Force members at our November 6, 1997 meeting.

This Paper expands on the recommendation in our earlier Interim Report that federal legislation clarify the Federal Energy Regulatory Commission's authority to approve and oversee the operations of a private standard-setting, electric-reliability organization.

The Task Force anticipates preparing additional papers on a variety of electric-reliability topics over the next nine months, leading to a final report.

The Task Force appreciates the opportunity to provide the Department with this Paper and respectfully submits the recommendations therein.

Sincerely,

Dr. Philip Sharp
Chairman,
Task Force on Electric System Reliability

Enclosure

cc: Federico Peña
Elizabeth Moler

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Secretary of Energy Advisory Board
Task Force on Electric-System Reliability

MAINTAINING BULK-POWER RELIABILITY THROUGH USE OF A SELF-REGULATING ORGANIZATION: POSITION PAPER

November 6, 1997

In its Interim Report, the Task Force recommended that federal legislation clarify the Federal Energy Regulatory Commission's (FERC) authority to approve and oversee the operations of an electric-reliability organization. This paper provides Task Force recommendations concerning the relationship between the FERC and a single, international, self-regulating reliability organization (SRRO) , such as a significantly reformed North American Electric Reliability Council (NERC) with a representative membership and governance system, to assure reliability of the bulk-power system.

1. BACKGROUND

Historically, NERC, the regional reliability councils, and individual utilities have managed reliability through a system of peer-reviewed standards coupled with voluntary cooperation and adherence to reliability rules. In that system, costs associated with maintaining reliability could be recovered through rates, and peer pressure and reciprocal treatment of costs were generally sufficient to keep utilities in compliance. Also, NERC, as an international organization, includes members from all countries sharing use of the interconnected transmission grid. Under this system, a set of effective reliability rules was developed and implemented.

The Task Force believes the system is clearly unsustainable in the increasingly decentralized and competitive U.S. electricity industry. Voluntary cooperation is unlikely to be sufficient because of the dramatic increase in the number of bulk-power transactions, the increased diversity of interests among participants, the growing unbundling (deintegration) of the electricity industry, the focus on price, and the lack of appropriate incentives for those entities contributing to reliability.

Most participants in and observers of the electricity industry agree that the voluntary system must be replaced with one that requires compliance with enforceable, non-discriminatory reliability rules applicable to all entities participating in the electricity market. This requires federal legislative authority.

NERC's Board of Trustees agreed in principle in January 1997 to require adherence to NERC rules and procedures. This new system attempts to feature: measurable performance standards, the requirement that all participants in bulk-power systems meet these standards, enforcement of these standards, and penalties for failure to comply with these standards. The detailed refinement of the standards and implementation of these principles is a work in progress.

Questions remain whether NERC has the authority to require industry participants to abide by the new rules and procedures in the absence of legislation. It is not clear whether the FERC has sufficient statutory authority to enforce NERC rules. The FERC has issued several

orders requiring parties to abide by the NERC standards and parties have assented to the requirements. However, the use of FERC's conditioning authority to enforce NERC standards has not yet been challenged. Others question whether the FERC should enforce these rules in light of concerns over NERC's governance and decision-making procedures.

In response to these concerns, the Task Force suggests that the U.S. Congress adopt legislation to clarify such authorities and enable the FERC to approve a national self-regulating organization to establish electric reliability standards similar to the National Association of Security Dealers (NASD) in the securities industry. Under federal law, the Securities and Exchange Commission (SEC) has authority to delegate significant regulatory authority to a number of private, member-owned and operated organizations in the securities industry. The SEC has authorized several self regulating organizations (SROs) under the statutory framework.

The experience in the securities industry has been relatively successful in this regard. Self regulation under a legal framework established by Congress, and administered and enforced by a duly appointed federal agency, has certain advantages over government regulation in terms of lower costs to the taxpayer, administrative efficiency and technical expertise in developing and enforcing technical standards, and greater compliance by the regulated firms (because they helped develop the regulations). On the other hand, without careful oversight from the government, SROs might not fully consider the perspectives of the general public and focus too narrowly on the interests of the industry being regulated, especially on issues that involve policy elements rather than technical issues.

SROs have been challenged in the courts and have been found to be legal, but only if properly structured. For example, the SEC Act was found to be a constitutional delegation because:
– The SEC has the power, according to reasonably fixed statutory standards, to approve or disapprove rules; and
– The SEC must make an independent decision on violations and penalties.

2. SRRO APPLICATION TO NERC AND THE FERC

Federal legislation should grant more explicit statutory authority to the FERC to approve and oversee an electric industry SRRO having responsibility for bulk-power reliability standards.

As the industry organization currently responsible for electric reliability, most of the members of the Task Force believe that the NERC and its regional reliability councils will evolve into an entity that could fill the role of the SRRO. Most believe the NERC has already initiated many of the changes that will be required for it to be the SRRO. However, we note

that this will not occur automatically. In order to qualify as the SRRO, a reformed NERC will have to meet all of the requirements of legislation and the FERC with respect to governance and processes.

The SRRO would provide the technical expertise on how best to maintain high levels of bulk-power reliability. The FERC would have regulatory oversight to ensure compliance with and ultimately resolve disputes over any SRRO mandatory reliability standards. The SRRO would produce mandatory standards applicable to all participants in the domestic and international bulk-power system. The FERC would either confirm SRRO mandatory standards or deny them and refer them back to the SRRO with comments requesting revision and resubmittal of the standards.

The SRRO would develop measurable performance standards. These mandatory standards would replace the voluntary requirements that NERC has previously relied on. Importantly, however, NERC must expedite the development and implementation of measurable standards in an open process that includes full and fair representation of all stakeholders and market participants. The Task Force recognizes that many non-utility participants have significant concerns about membership and representation and believe that NERC and the regional reliability councils must immediately open their membership to balanced representation of all stakeholders and market participants.

Legislation should provide for the following:
FERC review and approval of a proposal for an electric industry SRRO;
FERC implementation of mandatory reliability standards for the nation through rulemakings in accordance with the Administrative Procedures Act;
FERC jurisdiction for reliability over the bulk-power system including those portions owned or operated by federal, cooperative, and municipal utilities and all other entities participating in the electricity market;
FERC review and approval of all SRRO mandatory standards including specified incentives and penalties for compliance;
FERC ability to require the SRRO to develop, modify, or replace standards when necessary;
Mandatory application of reliability standards to all entities using or operating the bulk-power system;
SRRO enforcement of mandatory standards, including imposition of penalties or fines, subject to FERC review;
FERC authority to expedite or temporarily waive procedures when necessary to address an ongoing or imminent reliability problem;
When requested by the SRRO or on its own initiative (e.g., in an emergency situation or stemming from a complaint), FERC review of any SRRO governance or process issues,

standards, or SRRO enforcement action; and
Sufficient resources for the FERC to administer its new responsibilities including the authority to levy necessary fees on the industry and access industry computer models, data and transmission experts.

When considering an application for the SRRO, the FERC would give notice of the application and provide an opportunity for public comment in accordance with the Administrative Procedures Act. Particular consideration would be given to SRRO governance, processes, and funding. The SRRO must assure a fair governance process that cannot be dominated by any single industry sector. The FERC would review the application to ensure that the SRRO would function in a manner consistent with the public interest and national reliability policy.

Likewise, when reviewing SRRO mandatory reliability standards, the FERC would issue a notice of proposed rulemaking based on the standard and provide an opportunity for public comment. FERC approval of a standard would require a finding that the standard was fairly developed, is cost effective, and is consistent with the public interest and national reliability policy.

In recognition of the international nature of the interconnected transmission grid, the Task Force has taken the position that mandatory electric reliability standards must be developed by the SRRO and approved by the FERC in accordance with the Administrative Procedures Act. Standard development needs to be done by a single entity that can represent all countries using the interconnected transmission grid. Also, SRRO development of the mandatory standards would avoid the imposition of federally developed standards on those portions of the interconnected transmission grid located in Canada and Mexico. Currently, the Canadian government and electric industry is represented in NERC and it will be necessary to include both Canadian and Mexican representation in the SRRO. The interests of the United States would be protected by enabling the FERC to require the SRRO to develop or modify standards as necessary. It would be incumbent upon the SRRO to develop mandatory standards that are acceptable to all three countries.