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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Part 39

(Docket No. RM05-30-000; Order No. 672)

Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards

(Issued February 3, 2006)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final Rule.

SUMMARY: Pursuant to Subtitle A (Reliability Standards) of the Electricity Modernization Act of 2005, which is Title XII of the Energy Policy Act of 2005 (EPAct) and which added a new section 215 to the Federal Power Act (FPA), the Commission is amending its regulations to incorporate:

(1) Criteria that an entity must satisfy to qualify to be the Electric Reliability Organization (ERO) which the Commission will certify as the organization that will propose and enforce Reliability Standards for the Bulk-Power System in the United States, subject to Commission approval;

(2) Procedures under which the ERO may propose new or modified Reliability Standards for Commission review;

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

(3) A process for timely resolution of any conflict between a Reliability Standard and a Commission-approved tariff or order;

(4) A process for resolution of an inconsistency between a state action and a Reliability Standard;

(5) Regulations pertaining to the funding of the ERO;

(6) Procedures governing an enforcement action by the ERO, a Regional Entity or the Commission;

(7) Criteria under which the ERO may enter into an agreement to delegate authority to a Regional Entity for the purpose of proposing Reliability Standards to the ERO and enforcing Reliability Standards;

(8) Regulations governing the issuance of periodic reliability reports by the ERO that assess the reliability and adequacy of the Bulk-Power System in North America; and

(9) Procedures for the establishment of Regional Advisory Bodies that may provide advice to the Commission, the ERO or a Regional Entity on matters of governance, applicable Reliability Standards, the reasonableness of proposed fees within a region, and any other responsibilities requested by the Commission.

EFFECTIVE DATE: This Final Rule will become effective [insert date that is 30 days after publication in the **FEDERAL REGISTER**]

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

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SUPPLEMENTARY INFORMATION:

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

TABLE OF CONTENTS

I. INTRODUCTION 1
II. BACKGROUND 3
III. PROCEDURAL MATTERS 6
IV. DISCUSSION 7
A. Overview 7
B. Section-by-Section Discussion of the Final Rule 22
1. Definitions – Section 39.1 22
a. Terms Defined in the Statute 23
i. Bulk-Power System 23
ii. Reliable Operation 24
iii. Reliability Standard 24
iv. Transmission Organization 25
b. Additional Terms Commenters Seek to Define in the Final Rule 27
i. Physical Security Standards 28
ii. Regional Reliability Standard and Regional Variance 28
iii. User of the Bulk-Power System 28
iv. End User 30
(a) End User as a Retail Customer 31
(b) End User as a Customer that Uses the Bulk-Power System 32
(c) Broader Definition of End User 33
2. Jurisdiction and Applicability – Section 39.2 37
a. Commission Jurisdiction 37
b. International Regulatory Coordination 43
3. Electric Reliability Organization Certification - Section 39.3 48
a. The Oversight Roles of the Commission and the ERO 50
i. Building on the Existing Reliability Framework 51
ii. Concerns about an Excessively Rigid Hierarchal Reliability Framework 52
b. Statutory Certification Criteria 54
i. Governance 54
ii. Other Statutory Criteria 60
c. Opportunity for Public Comment 61
d. Non-statutory Criteria 62
i. Membership 62
(a) Open Membership 62
(b) Membership Fees 64
(c) Membership as a Requirement to Participate in the Reliability Standard Development Process 64
ii. Additional Non-statutory Criteria 68
e. Simultaneous Certification in Canada and Mexico 71
f. Periodic Performance Assessments 73

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

4. Funding of the Electric Reliability Organization – Section 39.4 78
a. Budget and Business Plan 79
b. Funding for Statutory Activities 82
i. General Funding Matters 83
ii. Funding Apportionment 84
c. Role of the ERO in Funding the Regional Entities 88
i. ERO Responsibility for Regional Entity Funding 89
ii. Commission Oversight of Regional Entity Funding 92
d. Funding Consistency with the Bilateral Principles 95
e. Payment of Dues and Funding Transition Plan 98
f. Billing Mechanics 99
g. Other Funding Matters 102
5. Reliability Standards – Section 39.5 104
a. Reliability Standard Development by the ERO and Regional Entities 105
i. Reliability Standard Development by the ERO 105
ii. Due Process in Reliability Standard Development 110
iii. Regional Uniformity and Variation of a Standard 112
iv. Rebuttable Presumption for a Reliability Standard Proposed by an Interconnection-wide Regional Entity 122
b. Reliability Standard Approval by the Commission 124
i. Commission Review 124
(a) Commission Review Process 124
(b) Legal Standard of Review of a Proposed Reliability Standard 126
ii. Due Weight to Technical Expertise of the ERO and a Regional Entity Organized on an Interconnection-wide Basis 136
iii. Due Weight to the Technical Expertise of a Regional Entity Not Organized on an Interconnection-wide Basis 138
iv. No deference on Competition 141
(a) Linkage between Reliability and Competition 141
(b) Definitions of Competition 143
(c) Commission Weighing of Competitive Effects 146
c. Effective Date 148
d. Remand of a Proposed Reliability Standard 149
i. Remand 149
ii. International Coordination of Remands 152
iii. Deadline for Submitting a Revised Proposal for a Reliability Standard in Response to a Remand 155
e. Commission-Initiated Actions on a Reliability Standard 158
i. Commission Directive that the ERO Address a Specific Issue 158
ii. Review of an Approved Reliability Standard 160
iii. Commission Authority to Void a Reliability Standard 162
6. Conflict of a Reliability Standard with a Commission Order – Section 39.6 166

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

7. Enforcement of Reliability Standards – Section 39.7 172
a. General Comments on Enforcement 173
b. Compliance 174
i. Enforcement Audits of Compliance with Reliability Standards 175
ii. Reliability-Related Programs 178
iii. Remedial Action 180
c. Assessing a Penalty for a Violation 184
i. Procedures for Investigations and Penalty Assessments 184
ii. Due Process 189
iii. Notice 191
iv. Effective Date of Penalty and Commission Review of Penalties 192
(a) Effective Date and General Commission Review 192
(b) Automatic Commission Review of Certain Penalties 198
v. Answer to an Application for Review 199
d. Nonpublic Matters and CyberSecurity Procedures 200
i. Stage at Which an Investigation or Penalty should be Made Public 204
ii. Nonpublic Treatment of Certain Types of Proceedings 206
e. Commission-ordered Compliance and Penalties 208
f. Penalties' Relation to the Seriousness of the Violation 211
i. Penalty Guidelines 213
ii. Non-Monetary Penalties 218
iii. Limits on Monetary Penalties 220
g. Reporting Violations and Alleged Violations 221
i. Procedures for Reporting Violations and Alleged Violations 221
ii. Confidentiality of Reports 226
h. Other Enforcement Issues 230
i. ERO and Regional Entity Appeals Processes 230
ii. Receipt and Use of Penalty Money 236
iii. RTO/ISO-Related Enforcement Issues 241
8. Delegation to a Regional Entity - Section 39.8 245
a. The Role of a Regional Entity and its Relationship to the ERO 245
i. Authority Delegated to a Regional Entity 248
ii. Other Regional Entity Activities 249
b. Process and Criteria for Becoming a Regional Entity 252
c. Review of a Regional Entity Applicant 259
i. Review of a Regional Entity Organized on an Interconnection-wide Basis 259
ii. Review of a Regional Entity Not Organized on an Interconnection-wide Basis 259
d. Eligibility of an RTO or ISO to Become a Regional Entity 263
e. Delegation Agreements 269
f. Regional Entity Governance 273
g. Notice Requirement for Submission of Delegation Agreements 278

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

h. Uniform Processes Among Regional Entities 279
i. Commission Assignment of Enforcement Authority Directly to a Regional Entity 280
j. Performance Assessment of Regional Entities 283
9. Enforcement of Commission Rules and Orders – Section 39.9 288
a. Action against the ERO or a Regional Entity 289
b. Audits of ERO and Regional Entity Criteria 291
c. Monetary Penalties 297
d. Penalizing an ERO or a Regional Entity Board Member 300
10. Changes in Electric Reliability Organization Rules and Regional Entity Rules - Section 39.10 302
11. Reliability Reports – Section 39.11 304
12. Inconsistency of a State Action and a Reliability Standard – Section 39.12 309
a. General Balance of Authority 310
b. Review of Allegedly Inconsistent State Actions 313
c. Concerns of Specific States 315
13. Regional Advisory Bodies – Section 39.13 319
V. INFORMATION COLLECTION STATEMENT 328
VI. ENVIRONMENTAL ANALYSIS 331
VII. REGULATORY FLEXIBILITY ACT CERTIFICATION 332
VIII. DOCUMENT AVAILABILITY 337

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

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

ORDER NO. 672

FINAL RULE

(Issued February 3, 2006)

I. INTRODUCTION

1. Pursuant to Subtitle A (Reliability Standards) of the Electricity Modernization Act of 2005, which is Title XII of the Energy Policy Act of 2005 (EPAct)[1] and which added a new section 215 to the Federal Power Act (FPA), the Commission is amending its regulations to incorporate:

(1) Criteria that an entity must satisfy to qualify to be the Electric Reliability Organization (ERO), which the Commission will certify as the organization

[1] Pub. L. No. 109-58, Title XII, Subtitle A, 119 Stat. 594, 941 to be codified at 16 U.S.C. 824o (2000).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

that will propose and enforce Reliability Standards for the Bulk-Power System[2] in the United States, subject to Commission approval;

(2) Procedures under which the ERO may propose new or modified Reliability Standards for Commission review;

(3) A process for timely resolution of any conflict between a Reliability Standard and a Commission-approved tariff or order;

(4) A process for resolution of an inconsistency between a state action and a Reliability Standard;

(5) Regulations pertaining to the funding of the ERO;

(6) Procedures governing an enforcement action by the ERO, Regional Entity or the Commission;

(7) Criteria under which the ERO may enter into an agreement to delegate authority to a Regional Entity for the purpose of proposing Reliability Standards to the ERO and enforcing Reliability Standards;

(8) Regulations governing the issuance of periodic reliability reports by the ERO that assess the reliability and adequacy of the Bulk-Power System in North America; and

(9) Procedures for the establishment of Regional Advisory Bodies that may provide advice to the Commission, the ERO or a Regional Entity on matters of

[2] Capitalized terms used in this Final Rule have the meanings specified in section IV.B.1 of the Preamble.

governance, applicable Reliability Standards, the reasonableness of proposed fees within a region, and any other responsibilities requested by the Commission.

2. The Commission believes incorporating this reliability rule into the Commission's regulations pursuant to the direction of Congress is an important step toward ensuring more reliable and secure electric utility service.

II. BACKGROUND

3. On August 8, 2005, EPAct was enacted into law by President Bush. New section 215 of the FPA provides for a system of mandatory, enforceable Reliability Standards. Reliability Standards are to be developed by the ERO, subject to Commission review and approval. An approved Reliability Standard may be enforced by the ERO, subject to the Commission's review, or the Commission may initiate an investigation or imposition of a penalty. Below, we summarize the provisions of Subtitle A of the EPAct:

4. Section 215(a) (Definitions) defines relevant terms used in the Act.

5. Section 215(b) (Jurisdiction and Applicability) provides that, for purposes of approving Reliability Standards and enforcing compliance with such standards, the Commission shall have jurisdiction over the certified ERO, any Regional Entities, and all users, owners and operators of the Bulk-Power System, including but not limited to the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

public and governmental entities described in section 201(f) of the FPA.[3] Section 215(b)(2) requires the Commission to issue a Final Rule to implement the requirements of section 215 of the FPA no later than 180 days after the date of enactment.

6. Section 215(c) (Certification) authorizes the Commission to certify a person as an ERO, provided that the applicant meets specified criteria.

7. Section 215(d) (Reliability Standards) provides the process for the ERO to propose a Reliability Standard, subject to Commission review and approval. This subsection also directs the Commission to adopt rules to establish a fair process for the identification and timely resolution of any conflict between a Reliability Standard and any function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission applicable to a Transmission Organization.

8. Section 215(e) (Enforcement) authorizes the ERO, after notice and opportunity for hearing, to impose a penalty for a violation of a Reliability Standard, subject to review by the Commission. This section also provides for enforcement initiated by the Commission on its own motion. Section 215(e)(4) requires that the Commission issue regulations

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[3] Section 201(f) of the FPA, 16 U.S.C. 824(f), provides that "[n]o provision in this Part shall apply to, or be deemed to include, the United States, a state or any political subdivision of a State, an electric cooperative that receives financing under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.) or that sells less than 4,000,000 megawatt hours of electricity per year, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto."

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

under which the ERO will be authorized to enter into an agreement to delegate authority to a qualified Regional Entity for the purpose of proposing Reliability Standards to the ERO and enforcing them. Further, subsection 215(e)(6) requires that any penalty imposed shall bear a reasonable relation to the seriousness of the violation and take into consideration timely remedial efforts.

9. Section 215(f) (Changes In Electric Reliability Organization Rules) requires Commission approval of any proposed ERO Rule or proposed Rule change.

10. Section 215(g) (Reliability Reports) requires that the ERO conduct periodic assessments of the reliability and adequacy of the North American Bulk-Power System.

11. Section 215(h) (Coordination With Canada and Mexico) urges the President to negotiate international agreements with the governments of Canada and Mexico to provide for effective compliance with Reliability Standards and the effectiveness of the ERO in the United States and Canada or Mexico.

12. Section 215(i) (Savings Provisions) states that the ERO shall have authority to develop and enforce compliance with Reliability Standards for only the Bulk-Power System and provides that section 215 of the FPA shall not be construed to preempt any authority of any state to take action to ensure the safety, adequacy, and reliability of electric service within that state, as long as such action is not inconsistent with any Reliability Standard. Section 215 also contains a provision relating specifically to reliability rules established by the State of New York.

13. Section 215(j) (Regional Advisory Bodies) requires the Commission to establish a Regional Advisory Body upon petition of at least two-thirds of the states within a region

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

that have more than one-half of their electric load served within the region. A Regional Advisory Body may provide advice to the ERO, a Regional Entity or the Commission.

14. Section 215(k) (Application to Alaska And Hawaii) provides that section 215 of the FPA does not apply to Alaska or Hawaii.

15. The statute directs the Commission to issue a Final Rule to implement the requirements of section 215 no later than 180 days after enactment, or by February 5, 2006. On September 1, 2005 the Commission issued a Notice of Proposed Rulemaking (NOPR) that proposed regulations regarding certification of the ERO, development of Reliability Standards, enforcement of Reliability Standards, ERO delegation of authority to Regional Entities, ERO funding and other matters necessary to implement the statute.[4]

III. PROCEDURAL MATTERS

16. The statute directs the Commission to issue a Final Rule to implement the requirements of section 215 of the FPA no later than 180 days after enactment, or by February 5, 2006. The Commission issued the NOPR on September 1, 2005. It required that comments be filed by October 7, 2005 to assist the Commission in meeting the statutory 180-day deadline. Several parties submitted late-filed comments. The

[4] Additional background information is provided in the NOPR, discussing the Commission's reliability-related activities and the development of voluntary reliability guidelines. Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards, 70 FR 53,117 (Sept. 7, 2005), FERC Stats. & Regs., Proposed Regulations ¶ 32,587 (Sept. 1, 2005).

Commission will accept these late-filed comments. A list of commenters appears in Appendix A.

17. Although the Commission did not request reply comments because of the relatively short statutory time frame for issuing a Final Rule, several commenters nonetheless submitted reply comments. The Commission will reject such reply comments. The Commission did not solicit reply comments and, therefore, accepting such comments from those who chose to submit them would be unfair to others.

18. The Commission held two technical conferences on this rulemaking. The first technical conference was held on November 19, 2005. Comments on the first technical conference were due by December 8, 2005. The technical conference was transcribed and is a part of the record in this docket.

19. The second technical conference was held on December 9, 2005. Comments on the second technical conference were due by December 23, 2005. The technical conference was transcribed and is a part of the record in this docket. A list of commenters for both technical conferences is in Appendix B.

IV. DISCUSSION

A. Overview

20. On August 8, 2005, EPAct was enacted into law. New section 215 of the FPA provides for a system of mandatory, enforceable Reliability Standards. Under the new electric power reliability system enacted by the Congress, the United States will no longer rely on voluntary compliance by participants in the electric industry with industry reliability requirements for operating and planning the Bulk-Power System. Congress

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

directed the development of mandatory, Commission-approved, enforceable electricity Reliability Standards.

21. The Commission will certify a single Electric Reliability Organization, the ERO, to oversee the reliability of the United States' portion of the interconnected North American Bulk-Power System, subject to Commission oversight. It will be responsible for developing and enforcing the mandatory Reliability Standards. The Reliability Standards will apply to all users, owners and operators of the Bulk-Power System. The Commission has the authority to approve all ERO actions, to order the ERO to carry out its responsibilities under these new statutory provisions, and also may independently enforce Reliability Standards.

22. The ERO must submit each proposed Reliability Standard to the Commission for approval. Only a Reliability Standard approved by the Commission is enforceable under section 215 of the FPA.

23. The ERO may delegate its enforcement responsibilities to a Regional Entity. Delegation is effective only after the Commission approves the delegation agreement. A Regional Entity may also propose a Reliability Standard to the ERO for submission to the Commission for approval. This Reliability Standard may be either for application to the entire interconnected Bulk-Power System or for application only within its own region.

24. The ERO or a Regional Entity must monitor compliance with the Reliability Standards. It may direct a user, owner or operator of the Bulk-Power System that violates a Reliability Standard to comply with the Reliability Standard. The ERO or

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entity may impose a penalty on a user, owner or operator for violating a Reliability Standard, subject to review by, and appeal to, the Commission.

25. On September 1, 2005 the Commission issued a NOPR that proposed regulations regarding certification of the ERO, development of Reliability Standards, enforcement of Reliability Standards, delegation of authority to Regional Entities, ERO funding and other matters necessary to implement the statute.

26. Based on careful consideration of the comments submitted in response to the NOPR, the Commission adopts a Final Rule that generally follows the approach of the NOPR. We note that numerous commenters express support for the NOPR and believe that the proposed regulations establish the framework for an effective ERO, as intended by Congress.[5]

27. The Final Rule is generally limited to developing and implementing the processes and procedures that section 215 of the FPA directs the Commission to develop and undertake with regard to the formation and functions of the ERO and Regional Entities. Section 215(b) obligates all users, owners and operators of the Bulk-Power System to comply with Reliability Standards that become effective pursuant to the process set forth in the statute. The Commission recognizes the critical need for an ERO that is effective in developing and enforcing mandatory Reliability Standards.

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[5] See, e.g., Ameren, CEOB, Exelon, FRCC, NASUCA, NERC, NiSource and TAPS.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

28. The Commission believes that, to achieve this goal, it is necessary to have a strong ERO that promotes excellence in the development and enforcement of Reliability Standards. Accordingly, various provisions of the Final Rule are intended to set out the ERO's role and responsibilities with respect to the users, owners and operators of the Bulk-Power System. The Final Rule requires periodic review of the ERO and Regional Entities to ensure that the statutory qualifying criteria are maintained on an ongoing basis.

29. A mandatory Reliability Standard should not reflect the "lowest common denominator" in order to achieve a consensus among participants in the ERO's Reliability Standard development process. Thus, the Commission will carefully review each Reliability Standard submitted and, where appropriate, remand an inadequate Reliability Standard to ensure that it protects reliability, has no undue adverse effect on competition, and can be enforced in a clear and even-handed manner. Further, the Final Rule allows the Commission to set a deadline for the ERO to submit a proposed Reliability Standard to the Commission to ensure that the ERO will revise in a timely manner a proposed Reliability Standard that is not acceptable to the Commission. These provisions, as well, will strengthen the ERO and Regional Entities by providing mechanisms to achieve effective and fair Reliability Standards.

30. The major provisions of the Final Rule are as follows.

1. <u>ERO Certification</u>

31. The Final Rule provides that the Commission will, after notice and opportunity for comment, certify one applicant as the ERO. The Final Rule sets forth the criteria that an

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

ERO applicant must satisfy to qualify as the ERO, including the ability to develop and enforce Reliability Standards.[6]

32. To ensure that the ERO complies with the certification criteria on an ongoing basis, the Final Rule requires the ERO to undergo a performance assessment three years after certification and every five years thereafter. The ERO must file a self-assessment with the Commission explaining how it satisfies the ERO requirements. Regional Entities, users, owners and operators of the Bulk-Power System, and other interested entities will have an opportunity to make recommendations for the improvement of the ERO. After receipt of the performance assessment, the Commission will establish a proceeding in which it will assess the performance of the ERO. The Commission will also allow opportunity for public comment. As a result of the performance assessment, the Commission will issue an order finding that the ERO meets the statutory and regulatory criteria or directing the ERO to comply or improve compliance with the statutory and regulatory criteria for the ERO. Subsequently, if the ERO fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order, including, if necessary and appropriate, a proceeding to consider decertification of the ERO.

33. The ERO submission must include an evaluation of the effectiveness of each Regional Entity. The Commission will, as part of its proceeding to assess the ERO's

[6] The criteria stated in the Final Rule track the statutory criteria for ERO certification provided in section 215(c) of the FPA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

performance, assess the performance of each Regional Entity and issue an order addressing Regional Entity compliance. If a Regional Entity fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order, including, if necessary and appropriate, a proceeding to consider rescission of the Commission's approval of the Regional Entity's delegation agreement.

2. ERO and Regional Entity Funding

34. Section 215 of the FPA generally provides for Commission authorization of funding for statutory functions, such as the development of Reliability Standards and their enforcement, and monitoring the reliability of the Bulk-Power System. The Final Rule clarifies, however, that while the ERO or a Regional Entity is not necessarily precluded from pursuing other activities, it may not use Commission-authorized funding for such activities.

35. The Final Rule directs ERO candidates to propose a formula or method of funding addressing cost allocation and cost responsibility, along with a proposed mechanism for revenue collection for Commission consideration. The Final Rule finds that funding based on net energy for load is one fair, reasonable and uncomplicated method that

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

minimizes the possibility of "double-counting."[7] However, the Commission does not rule out other apportionment methods that can be shown to be just and reasonable.

36. As the primary entity responsible for the development and enforcement of Reliability Standards, the ERO should fund the Regional Entities as well as approve their budgets, under the Commission's general oversight. The Final Rule requires periodic financial audits to ensure that any ERO-approved funding is appropriately expended for delegated functions. It addresses concerns that a significant amount of the ERO's or a Regional Entity's total revenue from an alternative source could compromise the mission or independence of the ERO or a Regional Entity.

37. The Final Rule provides that the ERO should include line item budgets for the activities that it delegates to each Regional Entity. The Final Rule permits the ERO to request emergency funding on a demonstration of unforeseen and extraordinary circumstances. It also clarifies that Commission review and approval of ERO and Cross-Border Regional Entity funding mechanisms will be limited to their application in the United States.

[7] Net Energy for Load means balancing authority area generation (less station use), plus energy received from other balancing authority areas, less energy delivered to balancing authority areas through interchange. It includes balancing authority area losses, but excludes energy required for storage at electric energy storage facilities, such as pumped storage.

3. Reliability Standards

38. The Final Rule implements the new FPA provisions relating to mandatory and enforceable Reliability Standards to be developed by the ERO. It establishes the ERO as the only entity that can submit a proposed Reliability Standard to the Commission for approval.

39. The Final Rule determines that the ERO's Reliability Standard development process must provide for reasonable notice and opportunity for public comment, due process, openness and balance of interests. The Commission observes that an American National Standards Institute (ANSI)-accredited process is one reasonable means of satisfying these requirements.

40. The Commission may approve a proposed Reliability Standard (or modification to a Reliability Standard) if it determines that it is just, reasonable, not unduly discriminatory or preferential, and in the public interest. In its review, the Commission will give due weight to the technical expertise of the ERO or a Regional Entity organized on an Interconnection-wide basis with respect to a proposed Reliability Standard to be applicable within that Interconnection. However, the Commission will not defer to the ERO or a Regional Entity with respect to a Reliability Standard's effect on competition.

41. The Commission seeks as much uniformity as possible in the proposed Reliability Standards across the interconnected Bulk-Power System of the North American continent. The Final Rule permits a regional difference in a Reliability Standard, in particular for a regional difference that is more stringent than a continent-wide Reliability Standard, including a regional difference that addresses matters that the continent-wide

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard does not, and a regional difference necessitated by a physical difference in the Bulk-Power System. The Commission would generally find acceptable a proposed regional difference that satisfies the statutory and regulatory criteria for approval of a proposed Reliability Standard and that is more stringent than a continent-wide Reliability Standard.[8]

42. The statute requires the ERO to apply a rebuttable presumption to a proposal for a Reliability Standard from an Interconnection-wide Regional Entity to be applicable within its Interconnection. The Final Rule clarifies that this rebuttable presumption refers to the burden of proof. Thus, if the ERO does not find that the presumption for a proposed Reliability Standard is adequately rebutted, it must accept it as just, reasonable, not unduly discriminatory or preferential, and in the public interest, and submit it to the Commission for approval.

43. Section 215(d)(6) of the FPA requires the Commission's Final Rule to include "fair processes for the identification and timely resolution of any conflict between a Reliability Standard and any function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission applicable to a transmission organization." Accordingly, the Final Rule provides a process for a user, owner or

[8] The Commission notes that the Bulk-Power System includes interconnected portions of the United States, Canada and Mexico. However, this Final Rule only applies to that portion of the Bulk-Power System within the United States (excluding Alaska and Hawaii).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

operator to notify the Commission of such possible conflicts for timely resolution by the Commission.

44. Further, the Commission interprets section 215 as generally permitting a state to take action, as long as such action is not inconsistent with a Reliability Standard. The Commission will consider the recommendation of a relevant state as well as the ERO and will require that a petition for determination of inconsistency be served on a relevant state agency.

4. Enforcement of Reliability Standards

45. The ERO is responsible under section 215(e) of the FPA for ensuring that all users, owners and operators of the Bulk-Power System comply with Reliability Standards. In addition, the statute provides that the Commission can, independent of the ERO, investigate compliance with a Reliability Standard and impose a penalty for a violation. The ERO may delegate its enforcement responsibilities to a Regional Entity. The Final Rule sets forth various elements of the enforcement process, including (1) the ERO and each Regional Entity is expected to have a compliance program that includes proactive enforcement audits to determine if users, owners and operators are complying with Reliability Standards; (2) the ERO and the appropriate Regional Entity will conduct investigations of alleged violations of Reliability Standards, and the ERO must inform the Commission promptly of these investigations and their disposition; and (3) the ERO or a Regional Entity may assess a penalty (non-monetary or monetary), subject to Commission review.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

46. The Final Rule requires the ERO to develop an enforcement audit program. In addition, any Regional Entity that receives a delegation of enforcement function also should have an audit program. The Final Rule explains that there should be a single audit program applicable to both the ERO and Regional Entities unless there is a compelling reason for a difference between the ERO and a particular Regional Entity.

47. The Final Rule implements the enforcement provisions of section 215(e) of the FPA, which authorize the ERO to impose a penalty for a violation of a Reliability Standard, subject to Commission review. The enforcement provisions in section 39.7 of the Final Rule allow the ERO or a Regional Entity with delegated enforcement authority to impose a penalty on a user, owner or operator of the Bulk-Power System for a violation of a Reliability Standard. The ERO will retain oversight responsibility for enforcement authority that is delegated to a Regional Entity. To ensure consistency in the implementation of delegated enforcement authority, a Regional Entity must report periodically to the ERO on how it carries out its delegated enforcement authority. The Final Rule makes clear that the ERO and Regional Entities must establish uniform Rules that provide adequate due process to an alleged violator when the ERO or Regional Entity is determining whether to assess a penalty. The Final Rule concludes that, to provide adequate due process yet prevent duplicative and unnecessary expenses, there should be a single opportunity for internal appeal within the ERO or Regional Entity. Further, the Final Rule establishes expedited procedures for Commission review of a penalty, as required by EPAct.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

48. The Final Rule discusses the ERO's and a Regional Entity's ability to take remedial action separate from its penalty authority. For example, the ERO or a Regional Entity may direct a user, owner or operator to come into compliance with a Reliability Standard.

49. The Final Rule requires the ERO to notify the Commission promptly of a self-reported violation or an investigation into a violation or alleged violation and its eventual disposition. This will allow the Commission to receive timely information on a violation or alleged violation of a Reliability Standard and determine whether Commission action is appropriate. The Final Rule requires the ERO to develop, and submit to the Commission for approval, penalty guidelines that identify a range of non-monetary and monetary penalties to be applied by the ERO for determining the appropriate penalty for violation of a Reliability Standard. Regional Entities should adopt the ERO's penalty guidelines with change only as necessary to reflect regional differences in Reliability Standards.

50. The Final Rule finds that an investigation conducted by the ERO, a Regional Entity, or the Commission of a violation or an alleged violation of a Reliability Standard will be nonpublic unless the Commission authorizes a public investigation. However, once the ERO or a Regional Entity imposes a penalty and files the statutorily-required "notice of penalty" with the Commission, the Commission will publicly disclose the penalty. The Final Rule includes an exception to this public disclosure with respect to Cybersecurity Incidents and other matters that would jeopardize system security.

5. Delegation to a Regional Entity

51. Consistent with the statute, the Final Rule establishes criteria for the ERO to delegate authority to a Regional Entity to enforce Reliability Standards and to propose Reliability Standards to the ERO. It sets out the role of a Regional Entity in relationship to the ERO, concluding that the ERO holds the primary responsibility for enforcement of Reliability Standards and that any delegation of this responsibility to a Regional Entity is subject to ERO oversight.

52. The Commission explains the process and criteria for becoming a Regional Entity. The Final Rule relies on statutory criteria for evaluating a Regional Entity applicant. Each application will be evaluated on a case-by-case basis. The Final Rule establishes a rebuttable presumption afforded to a proposal for delegation to a Regional Entity organized on an Interconnection-wide basis. This rebuttable presumption is that such a proposed Regional Entity promotes the effective and efficient administration of Bulk-Power System reliability. The Final Rule adopts a periodic Regional Entity performance assessment process administered primarily by the ERO.

53. The Final Rule addresses the subject of uniformity among delegation agreements. It emphasizes the value of uniformity and requires the ERO applicant to submit a pro forma delegation agreement concurrently with its ERO application. The Final Rule allows a prospective Regional Entity to submit a delegation agreement directly to the Commission if good faith negotiations with the ERO fail. The Commission strongly urges a prospective Regional Entity to consider the use of alternative dispute resolution (ADR) to resolve any disputes over the terms of the delegation agreement. The Final

Rule requires a prospective Regional Entity that submits a delegation agreement directly to the Commission to state whether ADR procedures were used and whether the Regional Entity believes that ADR under the Commission's supervision could successfully resolve the disputes regarding the terms of the delegation agreement. The Commission may, if appropriate, upon review, direct the ERO to enter into the delegation agreement with the Regional Entity.

54. The Final Rule clarifies that a Regional Entity should not directly submit a Regional Entity Rule or change to a Regional Entity Rule to the Commission because this is consistent with the role of the ERO overseeing the Regional Entities, as discussed below. The Final Rule directs the ERO to develop procedures and criteria by which a Regional Entity Rule or change to Regional Entity Rule will be judged by the ERO, and then be submitted to the Commission for approval.

55. The Final Rule provides for the establishment of Regional Advisory Bodies. It observes that it would generally be desirable to have a Regional Entity and a Regional Advisory Body cover the same region but does not require a Regional Advisory Body and a Regional Entity to have a common boundary. The Final Rule finds that section 215 of the FPA permits a Regional Advisory Body to form even if there is not yet a Regional Entity in a region, in part so that a Regional Advisory Body may advise the Commission and the ERO regarding the governance of a proposed Regional Entity.

6. Enforcement of Commission Rules and Orders

56. The Commission generally expects to work cooperatively with the ERO and Regional Entities to resolve issues that may arise. Nonetheless, the Final Rule clarifies

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the Commission's authority to take action against the ERO or a Regional Entity for non-compliance with section 215 of the FPA. The Final Rule provides that the Commission may take such action as is necessary and appropriate against the ERO or a Regional Entity to ensure compliance with a Reliability Standard or any Commission order affecting the ERO or a Regional Entity. The Commission may suspend or rescind the ERO's certification or a Regional Entity's delegated authority.

57. The Final Rule establishes the policy that, in general, the Commission oversees the ERO and the ERO oversees any approved Regional Entity. Consistent with this approach, the Final Rule provides that the Commission may periodically conduct a compliance audit to examine the ERO's compliance with the statutory and regulatory criteria for becoming the ERO and performance in enforcing Reliability Standards. The ERO must periodically audit each Regional Entity's compliance with relevant statutory and regulatory criteria for becoming a Regional Entity and performance in enforcing Reliability Standards and report the results to the Commission.

58. Although we would expect to use this provision only in extraordinary circumstances, the Final Rule allows the Commission to impose civil penalties on the ERO or a Regional Entity. The Final Rule does not provide for the assessment of a monetary penalty against a board member of the ERO or a Regional Entity.

59. The Final Rule is organized into 13 sections:

Section 39.1 -- Definitions,

Section 39.2 -- Jurisdiction and applicability,

Section 39.3 -- Electric Reliability Organization certification,

Section 39.4 -- Funding of the Electric Reliability Organization,

Section 39.5 -- Reliability Standards,

Section 39.6 -- Conflict of a Reliability Standard with a Commission order,

Section 39.7 -- Enforcement of Reliability Standards,

Section 39.8 -- Delegation to a Regional Entity,

Section 39.9 -- Enforcement of Commission rules and orders,

Section 39.10 -- Changes in Electric Reliability Organization Rules and Regional Entity Rules,

Section 39.11 -- Reliability reports,

Section 39.12 -- Review of state action, and

Section 39.13 – Regional Advisory Bodies

B. Section-by-Section Discussion of the Final Rule

60. Below, the Commission discusses the regulations proposed in the NOPR, the comments received, and the Commission's conclusion. We note that, while the NOPR indicated that the rules would be set forth in Title 18, Part 38 of the Code of Federal Regulations (CFR), the Final Rule codifies the rules in Title 18, Part 39 of the CFR. To provide consistency and clarity in the discussion of proposed rules, comments and Commission conclusions, the Final Rule refers to Part 39 or, when referring to a particular section within Part 39, section 39, throughout the discussion.

1. Definitions – Section 39.1

61. This section of the NOPR defined the relevant terms used in Part 39 of the Commission's regulations, including the terms that are defined in the statute to provide a

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

consistent meaning throughout the proposed rule. Comments relating to the proposed definitions are discussed below.

a. Terms Defined in the Statute

i. Bulk-Power System

62. The NOPR defined the term "Bulk-Power System" as set forth in section 215(a)(1) of the FPA:

> Bulk-Power System means facilities and control systems necessary for operating an interconnected electric energy transmission network (or any portion thereof), and electric energy from generating facilities needed to maintain transmission system reliability. The term does not include facilities used in the local distribution of electric energy.

63. Several commenters seek clarification to narrow the interpretation of the term "Bulk-Power System." National Grid asserts that the definition of "Bulk-Power System" is ambiguous as to whether it encompasses generation facilities and precisely which facilities are covered. National Grid recommends that the Commission clarify the term by adopting a functional interpretation rather than an arbitrary test based on a single attribute, such as voltage or facility capacity to identify facilities included as part of the Bulk-Power System. Hydro-Québec submits that the definition of "Bulk-Power System" should be interpreted narrowly, that is, jurisdiction on generating facilities should be strictly limited to that needed to maintain transmission system reliability, as ascertained by the ERO or the Regional Entity. NiSource, submits that the definition should exclude generating facilities and include the electric energy from those facilities only to the extent needed to maintain transmission system reliability. SoCalEd asserts that the Commission

should include generators that receive transmission service pursuant to a wholesale distribution access tariff in its jurisdiction.

ii. Reliable Operation

64. The NOPR defined the term "Reliable Operation" as set forth in section 215(a)(4) of the FPA:

> Reliable Operation means operating the elements of the Bulk-Power System within equipment and electric system thermal, voltage, and stability limits so that instability, uncontrolled separation, or cascading failures of such system will not occur as a result of sudden disturbance, including a Cybersecurity Incident, or unanticipated failure of system elements.

65. Kansas City P&L is concerned that including the phrase "unanticipated failure of system elements" in the definition of "Reliable Operation" makes it too vague for development of efficient and workable Reliability Standards related to reliability planning criteria. It recommends that the Commission either delete the phrase or explain the meaning of the phrase.

iii. Reliability Standard

66. The NOPR defined the term "Reliability Standard" as set forth in section 215(a)(3) of the FPA:

> Reliability Standard means a requirement, approved by the Commission under the instant proposed regulation, to provide for Reliable Operation of the Bulk-Power System. The term includes requirements for the operation of existing Bulk-Power System facilities, including cybersecurity protection, and the design of planned additions or modifications to such facilities to the extent necessary to provide for Reliable Operation of the Bulk-Power System. The term does not include any requirement to enlarge such facilities or to construct new transmission capacity or generation capacity.

67. The Oklahoma Commission finds this definition reasonable because it does not encompass any requirement to enlarge or construct new transmission or generation capacity; however, it seeks clarification that a Commission-approved Reliability Standard will apply equally to both existing facilities and new facilities added in the future.

iv. Transmission Organization

68. The NOPR defined the term "Transmission Organization" as set forth in section 215(a)(6) of the FPA:

> Transmission Organization means a Regional Transmission Organization, Independent System Operator, independent transmission provider, or other Transmission Organization finally approved by the Commission for the operation of transmission facilities.

69. South Carolina E&G asks the Commission to clarify that the definition of "Transmission Organization" includes a non-independent Transmission Provider that maintains separation of functions pursuant to Standards of Conduct Order No. 2004.[9]

Commission Conclusion

70. We adopt the NOPR's definition of "Bulk-Power System," "Reliable Operation," "Reliability Standard," and "Transmission Organization" because the definition of these

[9] Standards of Conduct for Transmission Providers, Order No. 2004, FERC Stats. & Regs., Regulations Preambles ¶ 31,155 (2003), order on reh'g, Order No. 2004-A, III FERC Stats. & Regs. ¶ 31,161 (2004), order on reh'g, Order No. 2004-B, III FERC Stats & Regs. ¶ 31,166 (2004).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

terms originates in section 215 of the FPA.[10] However, we offer the following clarifications.

71. With regard to generators, Congress included in the definition of Bulk-Power System "electric energy from generation facilities needed to maintain transmission system reliability." If electric energy from a generating facility is needed to maintain a reliable transmission system, that facility is part of the Bulk-Power System with respect to the energy it generates that is needed to maintain reliability. We conclude that the precise scope of generators as facilities to which the Reliability Standards apply would be best considered in the context of our review of those Standards, taking into account the views of the ERO and others. Therefore, until we have proposed Reliability Standards before us, we will reserve further judgment on whether additional guidance on generators' status as Bulk-Power System facilities is appropriate or whether the decision of which generators are Bulk-Power System facilities should be made on a case-by-case basis.

72. With regard to the term "Reliable Operation," we decline to generically interpret the meaning of the phrase "unanticipated failure of system elements" in advance of submission of proposed Reliability Standards requiring interpretation of the phrase or other specific instances where the issue and all of the relevant facts are presented to allow the Commission to make a proper determination.

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[10] 16 U.S.C. 824o(a) (2000).

73. With regard to the term "Reliability Standard," we clarify that a Reliability Standard will equally apply to the existing Bulk-Power System and any future additions to the Bulk-Power System unless the Reliability Standard itself provides for an exception. Section 215 of the FPA makes no distinction between existing and new facilities.

74. With regard to the term "Transmission Organization," we clarify that the transmission arm of a vertically integrated utility that is subject to the Commission's Standards of Conduct, absent any other relevant facts, would not be a Transmission Organization for purposes of FPA section 215(a)(6). Given that each of the examples of Transmission Organizations provided by Congress are independent of market participants, the Commission finds that Congress intended that "Transmission Organization" be an entity approved by the Commission that is independent of market participants. However, in response to South Carolina E&G, any interested person that perceives a possible conflict between a Reliability Standard and a tariff may bring this to the Commission's attention.

b. Additional Terms Commenters Seek to Define in the Final Rule

75. Commenters suggest seven new terms to define in the Final Rule: "Competition," "Physical Security Standard," "Potential Violation," "Regional Reliability Standard," "Regional Variance," "User of the Bulk-Power System" and "End User."[11]

[11] We address issues pertaining to "Competition" and "Potential Violation" in section IV.B.5 and section IV.B.7 of the Preamble, Reliability Standards and Enforcement of Reliability Standards, respectively.

i. Physical Security Standards

76. NERC recommends adding the defined term "Physical Security Standard":

> Physical Security Standard means a Reliability Standard adopted to safeguard personnel and prevent unauthorized access to critical equipment, systems, material, and information at critical facilities.

ii. Regional Reliability Standard and Regional Variance

77. NYSRC and the New York Companies recommend adding the defined term "regional reliability standard" to mean a Reliability Standard that is consistent with the generally applicable ERO Reliability Standard but is more specific or more stringent to meet the particular reliability needs of the region:

> Regional Reliability Standard: A Reliability Standard applicable within a particular region that is not inconsistent with, but may be more stringent, add detail to, or implement an ERO Reliability Standard, or may cover matters not covered by an ERO Reliability Standard.

78. While the New York Companies indicate that they would define term "regional variance" in the same manner, NYSRC would define this term separately, as follows:

> Regional Variance: An aspect of an ERO Reliability Standard that applies only within a given region. A Regional Variance may be used, for example, to exempt a particular region from all or a portion of an ERO Reliability Standard that does not apply to that region, or may establish different measures or performance criteria necessary to achieve reliability within that region.

iii. User of the Bulk-Power System

79. NERC proposes to add a definition for "user of the Bulk-Power System." NERC asks that the Commission require every such user to register with the ERO. It considers a user to be a direct user that transacts business on the Bulk-Power System subject to Commission jurisdiction under section 215 of the FPA. It would exclude an end-use

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

customer who receives electric energy indirectly from the Bulk-Power System. NERC proposes the definition:

> User of the Bulk-Power System means any entity that sells, purchases, or transmits electric power directly over the Bulk-Power System, or that maintains facilities or controls systems that are part of the Bulk-Power System, or that is a system operator. The term excludes customers that receive service at retail that do not otherwise sell, purchase, or transmit power over the Bulk-Power System or own, operate or maintain, control or operate facilities or systems that are part of the Bulk-Power System.

80. MidAmerican suggests that the Commission clarify that the use of local distribution in the term "Bulk-Power System" refers to the Commission's definition for local distribution as provided in Order No. 888 as the facilities that meet the seven factor test for distribution.

81. APPA states that it assumes that both the new ERO and the Commission will focus their reliability efforts on those entities with activities that substantially impact the Bulk-Power System, and that distribution-only entities will not be targeted because the Commission's jurisdiction under section 215 does not extend to local distribution activities. NRECA argues that status as a section 201(f) entity, ownership of distribution facilities, and even ownership of local transmission facilities should not be considered ipso facto to cause one to be deemed a "user, owner, or operator" of the Bulk-Power System for purposes of application of the Reliability Standards.

82. NRECA notes that a distribution cooperative serving customers entirely at retail and operating facilities at lower voltages might still be said to be a user of the Bulk-Power System to the extent that its electricity is delivered over higher-voltage facilities of its generation and transmission company or even the interconnected facilities of an

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

investor-owned utility and/or a federal power marketing agency or large public power entity. However, NRECA states that this is not a meaningful basis for interpreting the Commission's jurisdiction of "user" since the same reasoning would apply to a large industrial customer or, ultimately, even a single residential customer.

83. Therefore, NRECA asks that the Commission interpret "user" as one that has an active role in, and some measure of control over the Bulk-Power System, and whose activities have the potential to directly disrupt the Bulk-Power System, such as an owner or operator of a high-voltage transmission facility, a large generator, or a control area operator. Users should not include those that have no active role in or control over the Bulk-Power System.

iv. <u>End User</u>

84. The NOPR solicited comments on whether the term "end user" should be defined for purposes of the ERO's equitable allocation of reasonable dues, fees and charges among end users.[12] The NOPR further inquired as to whether the term "end user" should be defined as a customer using net energy for load or in terms of those who directly or indirectly use the Bulk-Power System. The NOPR asked whether we should limit the term to an entity transmitting electric energy through the transmission facility of another, or should "end user" include a transmission facility owner or operator with a business that depends on the Reliable Operation of the interconnected Bulk-Power System.

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[12] NOPR at P 43.

85. Several commenters submit that it is critical that the Commission define "end user" to establish a fair funding mechanism for the ERO and Regional Entities. These commenters, however, do not agree on how to define "end user" or are uncertain as to how best to carry out their recommendations, since certain users of the Bulk-Power System may not be allowed by local regulators to assess rates to recover such costs.

(a) End User as a Retail Customer

86. A number of commenters[13] recommend defining the term "end user" as a customer represented by net energy for load, i.e., an ultimate retail consumer. NASUCA submits that "end user" in section 215(c)(2)(B) of the FPA is intended to refer to a retail customer who actually uses the electricity that comes off the grid and, in this respect, is to be distinguished from a user, owner or operator of the Bulk-Power System that buys, sells, generates or transmits electricity at the wholesale bulk-power level and to whom the Reliability Standards directly apply. National Grid asserts that the plain language of the statute requires that "end user," not wholesale or transmission customers, fund the ERO so that applying the term only to direct users of the Bulk-Power System does not fit within the context of the statute.

87. A few commenters submit that "end user" should be defined in terms of a transmission provider that collects fees from customers and remits them to the ERO.[14]

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[13] See, e.g., NARUC, TAPS and PSE&G Companies.

[14] See, e.g., Allegheny, Hydro One and Detroit Edison.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Detroit Edison claims that the most equitable means by which the ERO could recover its costs from all consumers would be a direct bill targeted to all load. Given that the Commission's jurisdictional reach is limited, that portion of the ERO's charges attributable to domestic entities and approved by the Commission through the budget process should be deemed a prudently incurred transmission expense allocable to all transmission owners subject to the Commission's jurisdiction. This expense should be recoverable from wholesale and retail customers to ensure that all consumers, either directly or indirectly, share in the costs of maintaining and enhancing a reliable transmission network.

(b) <u>End User as a Customer that Uses the Bulk-Power System</u>

88. Several commenters, including BCTC and Old Dominion, recommend that the Commission include all users of the Bulk-Power System within the definition of the term "end user." MidAmerican submits that, if the term "end user" is defined as a customer using net energy for load, it should be made clear that the intent is to capture the end-use load of all direct or indirect users of the transmission system that benefit from the reliability of the Bulk-Power System.

89. MISO contends that the term "end user" should be broadly defined in the Final Rule to include an entity that directly or indirectly uses the wholesale transmission grid

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

so that any party receiving the benefits of Bulk-Power System reliability will bear the costs of promoting short-term reliability.[15]

90. NiSource and Entergy submit that the term should encompass independent system operators (ISOs), power marketers, qualifying facilities and all who directly or indirectly use the transmission systems and "drive system reliability."

91. SERC recommends including customers with alternative sources of generation in the definition of "end user." LADWP recommends that "end user" include all customer-owned distributed generation and merchant utility distributed generation, and that any entity with an obligation to serve should be assessed based on its end user responsibilities.

(c) Broader Definition of End User

92. A number of commenters suggest an expansive definition of "end user" that would include all users, owners and operators of the Bulk-Power System.

93. EEI recommends that the Commission define "end user" for the purpose of equitable allocation of ERO dues, fees and charges. It asks that the term be defined in the context of reliability, not in the context of electricity. EEI argues that generators and transmitting utilities are "end users" of reliability because they receive the benefits of reliability, just as retail electricity purchasers do. EEI submits that "end user" should

[15] See also AEP, Exelon, Entergy and NiSource.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

include any entity that buys or sells electric energy, or transmits electric energy as an owner, operator or user of the Bulk-Power System.

94. New York Companies recommends that "end user" be defined as an entity that injects energy into or withdraws energy from the grid, emphasizing that in areas of the country where deregulation has occurred, an entity that supplies power is different from an entity that withdraws power. It observes that entities responsible for paying the costs of an organization are more sensitive to the resource needs of that organization.

95. Wisconsin Electric asserts that the definition of "end user" should not encompass transmission owners or operators, or even end use customers of local distribution companies and marketers in retail access states, given the Commission's lack of jurisdiction over local distribution of energy.

Commission Conclusion

96. We decline to define all of these terms in this Final Rule without prejudice to the ERO proposing to define these terms as part of its certification application process or as part of a Reliability Standard. However, we offer the following clarifications.

97. In regard to the terms "regional Reliability Standard" and "regional variance," we recognize that regional "differences"[16] of several sorts are possible as more fully

[16] Throughout the Final Rule, we use the term regional differences to refer to any type or category of difference from a continent-wide Reliability Standard that applies on a regional basis.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

discussed under section IV.B.5, Reliability Standards, of the Preamble. There we call on the ERO applicant to propose definitions of the various types of differences.[17]

98. In regard to "User of the Bulk-Power System," we agree that a customer that receives electric service at retail and does not otherwise directly receive, sell, purchase, or transmit power over the Bulk-Power System or own, operate or maintain, control or operate facilities or systems that are part of the Bulk-Power System would not in general be considered to be a user of the Bulk-Power System.

99. We recognize that "User of the Bulk-Power System" is a critical jurisdictional term. However, at this time, we do not think it is appropriate to try and develop a specific definition. Generally, a person directly connected to the Bulk-Power System selling, purchasing, or transmitting electric energy over the Bulk-Power System is a User of the Bulk-Power System. With regard to NERC's proposed definition, we are concerned that a large industrial customer that receives electric energy directly from the Bulk-Power System may not be defined as a user of the Bulk-Power System, even though it may directly affect the reliability of the Bulk-Power System. We conclude that the precise scope of the term "User of the Bulk-Power System," and thus the extent of persons subject to the Reliability Standards, would be best considered in the context of our review of those Standards, taking into account the views of the ERO and others. Therefore, until we have proposed Reliability Standards before us, we will reserve further

[17] See also section IV.B.8 of the Preamble, Delegation to a Regional Entity.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

judgment on whether a definition of "User of the Bulk-Power System" is appropriate or whether the decision of who is a "User of the Bulk-Power System" should be made on a case-by-case basis.

100. With regard to local distribution facilities, Congress specifically exempted "facilities used in the local distribution of energy" from the definition of Bulk-Power System, and, as such, the Commission's regulations do not subject such facilities to the ERO's or a Regional Entity's Rules or the Commission-approved mandatory Reliability Standards. As noted by NRECA, the owner or operator of a local distribution facility can be a user of the Bulk-Power System. If the owner or operator of a local distribution facility is a "user" of the Bulk-Power System, it must comply with all relevant Reliability Standards as a user.[18]

101. We agree with commenters that there are good reasons to distinguish an "end user" from a "user, owner or operator of the Bulk-Power System." The latter phrase refers to an entity that must comply with the Reliability Standards, and perhaps also pay directly for the cost of the ERO. The term end user, is a term in common use in the electric power industry, which the Commission has used at times in its orders without a definition and no one has expressed any uncertainty about the meaning of the term. In general, it means a retail consumer of electricity. Therefore, we do not see a need to

[18] Similarly, an owner or operator of a generating facility may be a user of the Bulk-Power System without that facility necessarily being a part of the Bulk-Power System.

adopt a formal definition for "end user" here. If an ERO applicant believes additional definition is needed as part of its application for explaining its funding mechanism or for another reason, it may propose a definition at that time.

2. Jurisdiction and Applicability – Section 39.2

a. Commission Jurisdiction

102. This section discusses the Commission's jurisdiction under section 215 of the FPA and who must comply with this Final Rule. The NOPR explained that, consistent with section 215(b) of the FPA, for the purposes of approving and enforcing Reliability Standards established by the Commission in accordance with this new regulation, the Commission has jurisdiction over the ERO, any Regional Entities, and all users, owners and operators of the Bulk-Power System within the United States (other than Alaska and Hawaii) including, but not limited to, the entities described in section 201(f) of the FPA.

Comments

103. The Ohio Commission is concerned that a statement in the proposed rule may go beyond the powers delegated by Congress. It asserts that Congress indicated that the Commission would have jurisdiction over approval of the Reliability Standards established under the ERO, but went no further, neither regarding the Regional Entities nor the enforcement provisions.

104. NERC and EEI recommend that the regulations make clear that each user, owner or operator of the Bulk-Power System must comply with the Commission's regulations implementing the Act, with approved Reliability Standards, and with the Rules adopted by the ERO and Regional Entities. In addition, NERC and TAPS assert that the ERO and

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entities may need to obtain information or data from users, owners and operators of the Bulk-Power System to develop Reliability Standards and to ensure compliance with those Reliability Standards and, therefore, the Final Rule should require users, owners and operators of the Bulk-Power System to respond to such requests for data.

105. DOE states that the language of section 215 of the FPA gives the ultimate authority for the certification of the ERO and the enforcement of the Reliability Standards to the Commission. Therefore, DOE asserts that it is imperative that the Commission be able to direct the ERO to collect, validate, and preserve data related to reliability performance in such form as the Commission may require, and that the ERO be required to provide such information to the Commission upon request.

106. Exelon notes that not all entities subject to mandatory Reliability Standards currently report information through the regional reliability councils and to NERC. In its view, it is critical that all entities subject to ERO Rules be required to provide the Commission, the ERO, and the Regional Entities with data when requested. Therefore, Exelon suggests that the Final Rule include an additional section requiring all users, owners and operators of the Bulk-Power System to furnish the Commission, the ERO and the applicable Regional Entity with information requested in order to carry out their functions under this Final Rule.

107. Professor Robert Thomas raises the need for the Final Rule to establish procedures to ensure that the Commission has appropriate access to any relevant reliability data in a meaningful format. Professor Thomas suggests that, for the Commission to perform its

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

oversight function, it must receive timely information in connection with any potential violation of a Reliability Standard. He recommends that the Commission have unfettered access to specific real-time and other system data.

108. EPSA requests that the Commission require the ERO and each Regional Entity to adopt procedures to prevent the unintended disclosure of any data they obtain. Further, it asks that, in instances when it is necessary to disclose such information, the Commission require the ERO and Regional Entities to establish procedures to protect such information from disclosure beyond what is necessary to protect the reliability of the Bulk-Power System.

109. NERC, TAPS, and Exelon state that the Final Rule should provide a mechanism for the ERO and Regional Entitles to learn the identity of each user, owner and operator of the Bulk-Power System to ensure that each such entity complies with Reliability Standards. NERC and Ontario IESO assert that the Final Rule should implement this identification process by requiring each user, owner, and operator of the Bulk-Power System to register with the ERO and the appropriate Regional Entity.

110. ELCON suggests that a requirement that all entities subject to enforcement under section 215(e) of the FPA register with the ERO for administrative purposes should not be confused with dues requirements or any concept of membership. However, FRCC suggests that all users of the Bulk-Power System should be required to register with the ERO and the appropriate Regional Entity for both cost recovery and enforcement purposes.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission Conclusion

111. Section 39.2 of the regulations codifies the jurisdiction conferred by statute. Congress specifically gave the Commission jurisdiction over Regional Entities and enforcement of compliance with section 215 of the FPA. Section 215(b) specifically states:

> The Commission shall have jurisdiction, within the United States, over the ERO certified by the Commission …, any regional entities, and all users, owners and operators of the bulk-power system, including but not limited to the entities described in section 201(f), for purposes of approving reliability standards established under this section and enforcing compliance with this section. All users, owners and operators of the bulk-power system shall comply with reliability standards that take effect under this section. (emphasis added)

Thus, the Ohio Commission's concern that the proposed relationship between the Commission and a Regional Entity or the Commission's role in enforcement may go beyond the powers delegated to the Commission by Congress is unfounded.

112. The Commission notes that the proposed regulations in the NOPR did not specifically state that all users, owners and operators of the Bulk-Power System shall comply with Reliability Standards that take effect under Part 39. NERC and EEI recommend that the Commission add such an explicit requirement in the regulations. Although all entities subject to the Commission's reliability jurisdiction under section 215 of the FPA are required to comply with regulations promulgated under that section without an explicit requirement to do so, we will grant NERC's and EEI's request to explicitly state in the regulations that all users, owners and operators must comply with the regulations under Part 39.

113. Finally, NERC and EEI further request that the regulations require all users, owners and operators to comply with ERO Rules and Regional Entities Rules. Congress gave the Commission jurisdiction over all users, owners and operators of the Bulk-Power System, for purposes of, inter alia, enforcing compliance with Reliability Standards. As defined by the proposed rule, the Rules of the ERO and Regional Entities are the bylaws, rules of procedure and other organizational rules and protocols of the ERO or a Regional Entity, respectively. These Rules should be developed to further the ERO's and Regional Entities' purpose – which is to improve Bulk-Power System reliability. The Commission concludes that it is appropriate for each user, owner and operator of the Bulk-Power System to be required to abide by any such Commission-approved Rules. Therefore, we will add a subsection (b) to section 39.2, stating:

> (b) All entities subject to the Commission's reliability jurisdiction under section 39.2(a) shall comply with applicable Reliability Standards, the Commission's regulations, and applicable Electric Reliability Organization Rules and Regional Entity Rules made effective under this part.

114. The Commission agrees with commenters that, to fulfill its obligations under this Final Rule, the ERO or a Regional Entity will need access to certain data from users, owners and operators of the Bulk-Power System. Further, the Commission will need access to such information as is necessary to fulfill its oversight and enforcement roles under the statute. Section 39.2 of the regulations will include the following requirement:

> (d) Each user, owner or operator of the Bulk-Power System within the United States (other than Alaska and Hawaii) shall provide the Commission, the Electric Reliability Organization and the applicable Regional Entity such information as is necessary to implement section 215 of the Federal Power Act as determined by the Commission and set out in the Rules of the Electric Reliability Organization and each applicable Regional Entity. The Electric Reliability Organization and each

> Regional Entity shall provide the Commission such information as is necessary to implement section 215 of the Federal Power Act.

115. We also agree with EPSA that the ERO and each Regional Entity must adopt confidentiality Rules to prevent the unintended disclosure of such information. However, because the Commission has not certified an ERO or seen the Rules that it and the Regional Entities will propose pertaining to data access and retention, the Commission will not address with specificity what such a confidentiality Rule would entail. Rather, the ERO must address ERO disclosure-related Rules in its application for certification. If such Rules do not apply to all Regional Entities, then each Regional Entity must address its disclosure Rules in the delegation agreements. The ERO or the Regional Entity should review a request for confidential treatment and make a determination if it is reasonable.

116. Although we agree with Professor Thomas that having procedures in place for the Commission to have such information in meaningful formats is useful, we will not address this issue in the Final Rule. The complexity of this issue and the need for substantive input from the ERO, Regional Entities, and the industry on what a meaningful format would be and the feasibility and costs of providing information in such a format would be more appropriately addressed outside the context of this rulemaking.

117. Several commenters assert that the Commission should provide a mechanism for the ERO and Regional Entities to identify all users, owners and operators of the Bulk-Power System. The Commission agrees and finds that a registration requirement, as

suggested by NERC and the Ontario IESO, may help identify those entities subject to the Commission's reliability jurisdiction and the Reliability Standards and rules of the ERO or a Regional Entity. Therefore, the Final Rule includes a registration requirement at section 39.2, as follows:

> (c) Each user, owner and operator of the Bulk-Power System within the United States (other than Alaska and Hawaii) shall register with the Electric Reliability Organization and the Regional Entity for each region within which it uses, owns or operates Bulk-Power System facilities, in such manner as prescribed in the Rules of the Electric Reliability Organization and each applicable Regional Entity.

If, in the registration process, there remains a question whether a specific user or other entity is subject to this rule, it or the ERO may request the Commission's guidance on the matter.

118. Because the Final Rule provides for mandatory funding of the ERO and those functions that it may delegate to the Regional Entities, there should be no fee for registering with the ERO or a Regional Entity. Further, registration does not commit a person to membership. Membership issues are discussed further below.

b. <u>International Regulatory Coordination</u>

119. The statute contemplates that the ERO will be subject to the jurisdiction of the United States, Canada, and possibly Mexico. This section discusses how the Commission reconciles its exclusive authority to regulate the ERO within the United States and the exclusive authority of regulators in other countries to regulate the ERO within their borders. On August 9, 2005, the Federal-Provincial-Territorial Electricity Working Group (FPT Group) in Canada and DOE jointly submitted to the Commission "Principles for an Electric Reliability Organization that Can Function on an International

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Basis" (bilateral principles) based on stakeholder dialogues. The NOPR asked for comment on these bilateral principles and whether they should be included in the Final Rule. Many of these principles are presented below. Comments and Commission conclusions on those topics are treated in the appropriate location. Here, we discuss the general comments on the principles.

Comments

120. Many commenters, including MRO and BCTC, state that the bilateral principles are essential because they provide a foundation to guide the operation of the ERO as an international organization.[19] NERC states that it supports the bilateral principles and will be guided by them in developing its rules of procedure and ERO application. NERC asserts that the bilateral principles are a sound basis on which NERC expects that the appropriate regulatory authorities in Canada will extend recognition to the ERO.

121. Several other commenters submit that the Commission's oversight of the ERO and Regional Entities should be informed by the bilateral principles. CEA sees the Commission working cooperatively with Canadian authorities in the establishment of the ERO and Regional Entities, the development and approval of Reliability Standards, and the operation of the ERO and the Regional Entities. MRO views Canadian support as essential. Hydro One urges consistency with applicable Canadian and Mexican regulatory principles. While Detroit Edison supports the bilateral principles, it submits

[19] See also Hydro-Québec, APPA, MRO, ELCON, Detroit Edison and Ontario IESO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

that they fail to address how Reliability Standards will be interpreted by entities on each side of the border operating under disparate market rules. Detroit Edison is also concerned about whether the ERO, or its designated Cross-Border Regional Entity, will have the authority to enforce non-discriminatory Reliability Standards on all transmission users within its international footprint and define the terms used in those Reliability Standards, binding all entities within its footprint to those definitions.

122. Commenters ask the Commission to explain how it intends to work with regulators in Canada to provide for effective enforcement across boarders given the limits of the respective jurisdictions.[20] Commenters also urge the Commission to explain how cross-border compliance and enforcement will work in these situations.

123. American Transmission comments that the ERO cannot adjudicate differences between regulators with sovereign powers and cannot function effectively without the concerted efforts of all relevant regulators. Therefore regulators in the U.S. and Canada must develop their own coordination process, compatible with the bilateral principles, to achieve consensus prior to a remand or proposal to void a Reliability Standard and the enforcement appeals process. Further, American Transmission states that the specific jurisdiction of each regulator should be clear to all; no entity should be exposed to jeopardy from multiple jurisdictions for the same violation.

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[20] See, e.g., CEA, Hydro One and Detroit Edison.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

124. Northern Maine Entities ask how Canadian or Mexican utilities will be required to comply with Reliability Standards, the violation of which, by virtue of the Commission's approval of those Reliability Standards, will constitute a violation of the FPA. Northern Maine Entities are concerned that a user, owner or operator of the Bulk-Power System within the U.S. portion of a Cross-Border Regional Entity would be subject to mandatory compliance, while those in the Canadian or Mexican portion might operate under voluntary, unenforceable Reliability Standards. In addition, in the interests of consistency and fairness, Northern Maine Entities argues that the Commission's Final Rule should clarify that no Cross-Border Regional Entity may subject an entity within the United States to the jurisdiction of a foreign court.

125. On November 18, 2005, the Ambassador of Canada, the Honorable Frank McKenna, forwarded additional comments from the Canadian FPT Group on the international implications of the NOPR and the need for United States and Canadian reliability regulators to cooperate. The FPT Group reiterates several of the points made by numerous Canadian commenters and others that are addressed throughout this Final Rule. The FPT Group also emphasizes the need for continued cooperation among reliability regulators within the United States and Canada through the work of the United States-Canada Bilateral Electric Reliability Oversight Group (Bilateral Group) and other means on matters pertaining to certification of the ERO, approval of Cross-Border Regional Entities, remands of Reliability Standards, enforcement and imposition of penalties.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission Conclusion

126. We agree that for the ERO to be effective in maintaining Bulk-Power System reliability across national borders, it must be able to operate in an international arena. As American Transmission suggests, regulators in the U.S. and Canada should cooperate to help the ERO protect reliability in both countries. To this end, the Commission has worked with our partners in Canada to develop the Terms of Reference for the Bilateral Group, executed by the Commission, the U.S. Department of Energy, and the FPT Group on June 30, 2005 (the Terms of Reference).[21]

127. Pursuant to the Terms of Reference, the Bilateral Group is intended to have an ongoing role in identifying issues related to international aspects of the reliability framework and identifying options for resolution of those issues. The Bilateral Group intends to consult on international aspects of reliability policies and reliability regulatory issues.

128. With respect to Northern Maine Entities' concern that entities within the United States may be subject to mandatory compliance, whereas entities in Canada and Mexico may still operate under voluntary standards, Northern Maine's concern is outside our jurisdiction to address. EPAct requires the ERO to seek recognition in Canada and Mexico and we will work with our counterparts in Canada and Mexico regarding cooperative development of mandatory Reliability Standards.

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[21] Available at http://www.ferc.gov/industries/electric/indus-act/reliability/06-30-05-agreement.pdf

3. Electric Reliability Organization Certification - Section 39.3

129. Consistent with section 215(c) of the FPA, the NOPR proposed that any person may submit an application to the Commission for certification as the ERO within sixty (60) days following the issuance of the Final Rule. The Commission would then certify one applicant as the ERO, if the Commission determines that the applicant meets specified criteria set forth in the proposed regulations. An ERO applicant must demonstrate that it has the ability to develop and enforce Reliability Standards that provide for an adequate level of reliability of the Bulk-Power System. An ERO applicant must also document that it has established ERO Rules that assure its independence of the users, owners and operators of the Bulk-Power System. Such ERO Rules must further provide for allocation of reasonable dues, fees and charges among end users for all reliability activities, provide for fair and impartial procedures for enforcement of Reliability Standards, and provide reasonable notice and opportunity for comment, due process, openness, and balance of interests in developing Reliability Standards and otherwise exercising its duties.

130. The NOPR interpreted section 215(c) of the FPA to mean that the ERO must comply with the certification criteria on an ongoing basis, and that a violation of the certification criteria constitutes a violation of the FPA.[22]

[22] NOPR at P 38 - 39.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Comments

131. NERC and others support the proposed certification requirements as faithfully reflecting the requirements set forth in section 215 of the FPA. Several commenters address the oversight roles of the Commission and the ERO. Some commenters address statutory criteria for ERO certification, namely ERO governance. Others raise the procedural issue of whether the public would have an opportunity to comment on ERO applications. Commenters also address non-statutory ERO certification issues such as ERO membership, simultaneous certification in Canada and Mexico, and periodic recertification. Many commenters, in discussing the ERO certification criteria, note that their concerns apply to Regional Entity formation as well.

132. The Oklahoma Commission states that, while Congress expressed clear intent that "[t]he Commission shall issue a rule to implement the requirement of this section not later than 180 days after the date of enactment…," Congress also expressed clear intent that due process and other rights be honored. Thus, it asserts that the Commission should regard some of the regulations in the Final Rule as interim "place-holders" and be prepared to add to, or review, the regulations after the Commission and the interested parties have an opportunity to determine how well they implement the due process requirements and other requirements of the statute.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

a. The Oversight Roles of the Commission and the ERO

133. Many commenters recommend a strong ERO under the general oversight of the Commission.[23] They view the Commission primarily relying on the ERO to ensure that each Regional Entity is properly performing its responsibilities.

134. Other commenters suggest more of a partnership relationship among the ERO, Regional Entities, the federal government and state governments. In this vein, for instance, Indianapolis P&L urges the Commission to be light-handed in its oversight of the ERO and provide it considerable flexibility to carry out its mission. In its view, the ERO should be a technically competent, fact-finding organization that will have the full confidence of stakeholders and be authoritative in and of itself.

135. Some commenters suggest that the Commission should carefully balance the need for a strong ERO with regional and state needs in the transition to enforceable Reliability Standards. EEI sees the need for a strong international ERO coupled with a significant role for Regional Entities. EEI supports the initial steps that NERC has taken to implement the changes necessary for certification as the ERO. In its view, timely recognition of NERC as the ERO and approval of initially proposed ERO Reliability Standards, on an interim basis if necessary, are critical steps in maintaining the reliability of the nation's Bulk-Power System.

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[23] See, e.g., ELCON and NRECA.

i. Building on the Existing Reliability Framework

136. Some commenters suggest building upon the NERC/regional reliability council framework. Empire District Electric asserts that it is essential for the Commission to promulgate a comprehensive, well-thought-out transition and implementation plan for the business processes, requirements, and accountabilities of NERC, the ERO, the existing regional reliability councils, the existing Regional Transmission Organizations (RTOs), and North American Energy Standards Board (NAESB). The Commission should allow sufficient time for the transition from NERC to the ERO, transition of regional reliability councils to Regional Entities, and Regional Entity coordination with existing security coordinators. NARUC suggests that the Commission should build on and transition from the current reliability organizations to preserve efficiencies and reliability. Starting over would be non-productive, economically wasteful and, most importantly, would put system reliability at risk.

137. AEP maintains that timely recognition of NERC as the ERO, and the proposed ERO Reliability Standards with whatever modifications are required by the Commission, is a critical step in ensuring the reliability of the nation's Bulk-Power System. NPCC asserts that the statute recognizes that there will be a partnership between the federal government, the ERO, the Regional Entities, and the states in the development of continent-wide Reliability Standards and Reliability Standards to be effective only within a region. EEI submits that understanding and recognition of the critical reliability functions carried out at the regional level, and a smooth transition to the new statutory

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

scheme whereby Regional Entities can propose regional Reliability Standards and carry out enforcement duties delegated to them by the ERO, are critical to ensuring reliability.

ii. Concerns about an Excessively Rigid Hierarchal Reliability Framework

138. Some commenters express concern about a new reliability bureaucracy. Alcoa, for instance, is concerned that the creation of a new bureaucracy has the potential to duplicate reliability costs and expenses already incurred by public utilities and consumers. PacifiCorp is concerned that the Final Rule could establish an excessively hierarchical and rigid ERO-Regional Entity framework that could needlessly complicate effective Reliability Standards development and compliance in Interconnection-wide regions. Similarly, NiSource asserts that, without some procedural clarification, the NOPR's multilayered and overlapping responsibilities of the ERO, Regional Entities and the Commission may lead to a cumbersome and overly complex process with overlapping or conflicting authority or duplicative efforts that cause confusion.

139. ELCON urges that the Final Rule preserve the intent of the law to eliminate the fragmented lines of authority that currently exist between NERC, regional reliability councils, RTOs and transmission owners. It further states that the Commission should resist any efforts to preserve outmoded, existing industry governance structures, relationships, and habits that prevent a world-class organization from emerging from the ERO certification process. NASUCA asks the Commission not to overlook the fact that the cost of the ERO, Regional Entities and Reliability Standards will ultimately be borne by consumers.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission Conclusion

140. The Commission finds that a strong ERO is critical to maintaining Bulk-Power System reliability. The ERO generally should be the point of contact between the Commission and the Regional Entities in carrying out reliability responsibilities pursuant to this Final Rule. Although we disagree with Indianapolis P&L that the Commission should necessarily be light-handed in its oversight of the ERO, we do recognize the need to be flexible in carrying out our regulatory oversight responsibilities.

141. In this Final Rule, the Commission gives the ERO guidance as to the content of its application and certain functions it must undertake, including its relationships with the Regional Entities. In certain areas, the Commission asks that the ERO applicant provide more detail regarding how it intends to perform its functions within the parameters set out in section 215 of the FPA and by the Commission.

142. The Commission understands the need for an orderly transition from the current approach of voluntary reliability standards under NERC and the regional reliability councils to the mandatory regime under the Commission's ultimate oversight through the ERO and Regional Entities. The Commission intends to provide industry participants adequate time to transition from the current system of voluntary reliability standards to mandatory Reliability Standards under the ERO. The Commission's process of certifying the ERO and approving Regional Entities and their delegation agreements and Reliability Standards will provide for public notice and comment to allow industry participants to weigh in on any potentially disruptive changes. If transition issues become a problem in the future, the Commission will address them at that time.

143. Several commenters express support for NERC as the ERO. The Commission will, however, not prejudge whether any specific entity should be certified as the ERO.

144. We agree with the Oklahoma Commission that the Commission may, at any time it sees a need, augment or modify its regulations. It may propose to do so in another NOPR or issue supplemental orders to provide interpretation or guidance on compliance or other matters. However, we regard the provisions of this Final Rule as more than a "place-holder." The regulations contained in this Final Rule are not intended as a halfway step, but as the permanent regulations concerning section 215 of the FPA, unless and until we determine that revision is required.

b. Statutory Certification Criteria

145. Section 215(c) of the FPA lays out certain statutory criteria that any ERO applicant must meet before being certified by the Commission. The Commission included these statutory criteria in the proposed regulations on certification. The comments on this section primarily address the issue of governance.

i. Governance

146. The NOPR proposed that an ERO candidate must demonstrate in a certification application that it has established Rules that assure its independence from the users, owners and operators of the Bulk-Power System, while assuring fair stakeholder representation in the selection of its directors and balanced decisionmaking in any ERO

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

committee or subcommittee.[24] The NOPR asked for comment on whether the ERO certification criteria should specify that the number of board members representing each participating country in the ERO must be in rough proportion to total load and whether there should be an opportunity for each country to have an equitable number of members on an ERO committee based on total load.[25]

Comments

147. Many commenters express concern and offer suggestions regarding the proper means to assure ERO independence and more balanced decisionmaking in terms of opportunities to be represented and more inclusive participation.[26] The California ISO maintains that independence from market participants and owners, users and operators of the Bulk-Power System should extend from the board level down to the staff level. NASUCA urges that, where a Regional Entity uses a stakeholder board, the concept of a balanced board cannot be accomplished without opportunity for adequate consumer representation. PG&E requests clarification as to how the ERO should achieve both fair stakeholder representation and the necessary expertise while maintaining its independence.

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[24] NOPR at P 40.

[25] Id. at P 57.

[26] See, e.g. NASUCA, SMA, EPSA and PG&E.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

148. With regard to balanced decisionmaking, many commenters express concern that the ERO provide for openness and inclusiveness, particularly with regard to representation on any stakeholders committee.[27] Some commenters, such as TAPS, specifically ask that the Final Rule provide guidance on the NOPR's requirement for balanced decisionmaking in any ERO committee or subordinate organizational structure. The California ISO states the stakeholder representation must be balanced on both an industry sector and geographic basis and that all distinct industry segments, including ISOs and RTOs, should have fair representation. NASUCA maintains that consumers should be fully represented on the stakeholders committee that advises the board and, where a Regional Entity establishes a stakeholder board, consumers must have direct representation on that board. Siemens states that equipment suppliers should also be allowed to participate and offer their expertise.

149. Commenters discuss the need for Rules on fair voting. For example, ELCON suggests that a stakeholders committee should directly elect the members of the board, vote on bylaws and amendments to the bylaws, and vote on other governance issues. Others suggest that no two stakeholder sectors should be able to control the vote on any matter, no single sector should be able to defeat a matter, and no entity should be eligible to be a member of more than one sector in the board selection process and the Reliability

[27] See, e.g., NRECA, SMA and California ISO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Standard development process, or in any committee, subcommittee or other subordinate organizational structure.[28]

150. Most commenters favor country representation requirements for the ERO board. Some comment that the ERO certification criteria should specify that the number of board members and committee members in the ERO and the Cross-Border Regional Entities should be in proportion to load of each participating country.[29] International Transmission states that Canadian board representation is important because of the interconnected nature of the Bulk-Power System and the need to minimize the likelihood that a Canadian regulatory body would find it necessary to remand a Commission-approved Reliability Standard to the ERO. The ERO must be seen as a forum for the expression of views and resolution of issues raised by Canadian users, owners and operators. APPA does not believe that the Final Rule should specify in detail the representation of each country on the ERO's board and committees but, rather, generally require that the ERO have appropriate international representation and allow the ERO to work out the details.

151. Commenters, however, do not consistently favor mandatory country representation for ERO committees. For example, ERCOT states that, while the ERO board and standing committee levels should have appropriate country representation, such

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[28] See, e.g., NASUCA and TAPS.

[29] See, e.g., Alberta, NERC and the New York Companies.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

representation on ERO subcommittees should be optional, depending upon the nature of the issues that are addressed. BCTC suggests that national representation should be required on ERO subcommittees, but only to the extent that eligible candidates are put forward. Santee Cooper suggests that the emphasis should be more on the technical expertise of those who would populate the ERO's committees and other subordinate groups. Hydro-One advocates that there be periodic rotation of the Chair/Vice-Chair among each participating nation with maximum terms. Southern submits that a country representation requirement could prove problematic in practice and difficult to implement and manage in every ERO working group. In this regard, ELCON notes the recent experience of NERC and NAESB with under-populated segments.

Commission Conclusion

152. The Commission recognizes that there are many ways that an ERO could provide balanced governance and decisionmaking. The Commission will not mandate a specific approach to ERO governance but, rather, will allow an ERO candidate to develop a proposal to be provided in its application for certification. Consistent with the Final Rule, an ERO applicant's proposal must include ERO Rules that assure the ERO's independence from the users, owners and operators of the Bulk-Power System, while assuring stakeholder representation in the selection of its directors and balanced decisionmaking in any ERO committee or subordinate organizational structure.

153. Appropriate ERO Rules should include provisions specifying that, on a committee or other subordinate organizational structure, no two stakeholder sectors should be able to control the vote on any matter, no single sector should be able to defeat a matter, and no

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

entity should be eligible to be a member of more than one sector in the board selection process,[30] unless the ERO adequately explains why it cannot apply these principles.

154. On the matter of country representation requirements, for the reasons discussed below, the Commission finds generally that it would be appropriate for country representation on the ERO board to be in rough proportion to the net energy for load of each participating country. We encourage ERO applicants to consider such a country representation requirement and explain any departure from this principle. We clarify that we are using the term "country" representation rather than "national" representation because we are not referring to representation by government officials but by persons associated with each participating country. Appropriate country representation on the board would assure that the ERO is truly international in addressing Bulk-Power System reliability. This is important given the interconnected nature of the Bulk-Power System. Further, appropriate country representation would assure that the ERO is aware of and considers the concerns of parties in each country participating in the ERO when addressing reliability matters.

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[30] Cf., Regional Transmission Organizations, Order No. 2000, FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,089 at 31,226, 31,074 (1999), order on reh'g, Order No. 2000-A, FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,092 (2000), affirmed sub nom. Public Utility District No. 1 of Snohomish County, Washington v. FERC, 272 F.3d 607 (D.C. Cir. 2001). ("Where there is a governing board with classes of market participants, we would expect that no one class would be allowed to veto a decision reached by the rest of the board and that no two classes could force through a decision that is opposed by the rest of the board").

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

155. With regard to ERO committees and subcommittees or other subordinate organizational structures, we encourage the ERO to allow equal opportunity for participation from each country to be on such committees. However, we decline to require that every committee have exact proportional representation. As noted by some commenters, technical expertise and other factors may be equally important in selecting committee members from a pool of volunteer candidates. For similar reasons, the Commission declines to require the ERO to adopt specific Rules for the selection of the committee Chair and Vice-Chair. That is a matter for those forming a proposed ERO to address in developing proposed ERO Rules.

ii. Other Statutory Criteria

156. The NOPR's proposal on certification requirement also specified other statutory criteria for ERO certification, such as a requirement that the ERO applicant must demonstrate that it has the ability to develop and enforce Reliability Standards that provide for an adequate level Bulk-Power System reliability. It also proposed that ERO Rules must allocate equitably reasonable dues, fees and charges among end users for all activities under this new reliability regulation. It further provided that ERO Rules are to be fair and impartial procedures for enforcement of Reliability Standards through the imposition of penalties, including limitations on activities, functions or operations, or other appropriate sanctions. In addition, it provided that such ERO Rules are to provide for reasonable notice and opportunity for public comment, due process, openness, and balance.

157. No comments were filed on the proposed text of these regulations. The Commission adopts the regulation text of the NOPR. However, further comments on the substance of these requirements are discussed below as follows: comments on dues, fees and charges of the ERO are discussed in section IV.B.4 of the Preamble, comments on the development of Reliability Standards are discussed in section IV.B.5 of the Preamble, and comments on the enforcement of Reliability Standards are discussed in section IV.B.7.

c. Opportunity for Public Comment

158. NiSource is concerned that there is no express provision in the proposed regulations to allow for public comment once an ERO candidate submits a certification application. They contend that the overall process would benefit if the Commission provided an opportunity to comment on whether the ERO applicants meet the certification criteria. Likewise, PG&E states that, although the selection of the ERO or a Regional Entity will affect users, owners and operators of the Bulk-Power System, neither the proposed section on certification nor the proposed section on delegation expressly allows for public comment.

Commission Conclusion

159. The Commission will provide notice and an opportunity for public comment when selecting the ERO or approving a Regional Entity delegation agreement and has written the Final Rule accordingly. This will allow interested persons an opportunity to voice their concerns and will assist the Commission in making an informed decision with respect to ERO certification and the delegation of ERO responsibilities to a Regional

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Entity. Accordingly, the Final Rule modifies the proposed regulations to provide for notice and an opportunity for comment selecting the ERO or approving a Regional Entity delegation agreement.

d. Non-statutory Criteria

160. Some commenters recommend the inclusion of other certification criteria, in addition to those set forth in the NOPR. The bulk of the commenters asking that the Commission address non-statutory criteria request that the Commission address the issue of membership.

i. Membership

161. The statute neither requires nor prohibits an ERO structure that allows persons to have membership in the ERO. Nor did the NOPR discuss whether the ERO should allow membership. Further, the NOPR asked for comment on whether membership in the ERO or a Regional Entity should be a condition for participation in either the ERO's Reliability Standard development process or that of a Regional Entity.[31] Numerous commenters discuss their concerns regarding the responsibilities and rights of any members, the openness of membership, and the level of membership fees.

(a) Open Membership

162. A few commenters, such as EPSA, urge the Commission to establish membership principles or require that the ERO be ANSI accredited. Numerous

[31] NOPR at P 56.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

commenters insist that, if the ERO has members, that membership policies should allow for open membership so that limited membership does not become a barrier to participation in the ERO.[32] NRECA, for instance, notes that, early on, it had joined the broad coalition of industry participants to support EPAct based on an agreement that mandatory Reliability Standards should be drafted and enforced by a self-regulatory industry organization that would have access to the engineering expertise of all the stakeholders. ELCON asserts that the ERO should have an open door policy and, if a membership requirement is allowed, anyone wishing to be a member of the ERO should be allowed to become a member without any explicit or implied barriers to membership. NASUCA submits that consumer representatives should be entitled to full membership and voting rights. Ameren suggests that members should not be subject to any obligations that place burdens on members' resources, such as mandatory participation in reliability audits.

163. APPA states that membership rights should be limited to participation in the development of internal ERO Rules and voting to select or approve slates of nominees to the ERO board.[33]

164. Most commenters made similar comments regarding the openness of Regional Entity membership. FRCC, however, asserts that, because Commission jurisdiction over

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[32] See, e.g., ELCON, EPSA, NASUCA and NRECA.

[33] See also EPSA and MRO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entities is limited to their delegated authorities and functions, membership or other participation policies of Regional Entities are not related to delegated authorities and, thus, not subject to Commission jurisdiction.

(b) Membership Fees

165. Many commenters either oppose membership fees or recommend limiting them to nominal amounts, should the ERO allow membership. For example, EPSA contends that membership fees for joining or leaving a Regional Entity must not become a barrier to entry or exit. APPA contends that membership fees tend to discourage broad participation by Bulk-Power System users, especially the smaller entities, while generally raising minimal amounts of revenue and suggests that annual fees should be no more than $1,000 per year per organization. ELCON contends that charging end users additional fees or dues as a condition to membership in the ERO is discriminatory and contrary to the statutory mandate of equitable allocation of reasonable dues, fees and charges. It suggests that the Final Rule provide that fees must be non-discriminatory and not duplicate charges that end users are already assessed. Similarly, NASUCA advocates that consumers should not have to pay for the ERO twice – through rates and then again through membership fees or dues.

(c) Membership as a Requirement to Participate in the Reliability Standard Development Process

166. Many commenters recommend that, assuming the ERO establishes a structure that allows for membership, membership should not be a requirement to participate in the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard development process.[34] For example, National Grid comments that membership must be open to satisfy the statutory requirement that the Reliability Standard development process allow for "public comment, due process, openness and balance of interests."

167. Alcoa suggests that any entity that believes that its interests would be affected by a Reliability Standard should be allowed to participate. Several commenters assert that a membership requirement would be inconsistent with ANSI accreditation of the process.[35] PSEG Companies notes that ANSI processes have long been recognized as best for meeting the requirements of OMB Circular A-119, which sets forth the requirements for federal agencies to utilize consensus standards developed by industry stakeholders. The North Carolina Commission points out that, as a state commission, it could not become an ERO member.

168. In contrast, Ameren and International Transmission comment that membership in the ERO should be a requirement of participation in the Reliability Standard development process. International Transmission suggests that the membership requirement should be coupled with fair and equitable membership Rules so that all entities should have an equitable influence on the Reliability Standard development process. New York Companies assert that ERO members should be the primary participants in developing a

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[34] See, e.g., NRECA, NERC, NE Pool Participants, Progress Energy, AEP, EEI, South Carolina E&G, SERC, TVA, Ontario IESO and Hydro-Québec.

[35] See, e.g., AEP, NRECA and South Carolina E&G.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard, but that the process should be transparent so that all interested parties are aware of the proposed Reliability Standard under development, either directly or through a Regional Advisory Body.

169. Other commenters suggest that, while membership in the ERO should not be a condition for participation in Reliability Standard development, registered membership should be a necessary condition for the right to vote on a proposed Reliability Standard.[36] SMUD adds that members would benefit from advice offered by non-members participating in Reliability Standard development. SoCalEd states that only those entities directly and materially affected by the reliability of the Bulk-Power System should be allowed to vote on a Reliability Standard. Those who are not affected by a Reliability Standard should not be able to jeopardize the reliability of the system.

Commission Conclusion

170. The Commission will neither require nor preclude a particular membership structure. Rather, the ERO applicant should determine whether membership is useful and appropriate in fulfilling its roles under EPAct and, if so, should submit any ERO Rules on membership to the Commission as part of its ERO application. If the ERO decides to create a membership structure, membership must be open to allow full and fair participation of all interested stakeholders through their representatives. Open membership is consistent with the statutory requirement that the ERO establish Rules that

[36] See, e.g., EEI, SMUD, American Transmission, Kansas City P&L, Southern and Xcel Energy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

assure fair stakeholder representation in the selection of board members and balanced decisionmaking in any ERO committee or subordinate organizational structure.[37]

171. Moreover, we conclude that, if the ERO decides to establish a membership structure, the ERO may charge only a nominal fee as a condition of membership. First, the Commission is not persuaded that membership fees, nominal or otherwise, are necessary given that the Final Rule provides for mandatory funding of the ERO and those functions that it may delegate to a Regional Entity. Also, we share the concern of commenters that a membership fee should not become a limitation on participation in the ERO or a Regional Entity. To ensure that all interested stakeholders have an opportunity to participate, if the ERO chooses to charge a nominal membership fee, the ERO should have a Rule providing that it may waive the fee for good cause shown.

172. With regard to Reliability Standard development, we agree with the majority of commenters that principles of due process and openness, as set forth in section 215(c)(2)(D) of the FPA, dictate that membership must not be a condition for participating in Reliability Standard development, or for voting on the approval of a Reliability Standard. Section 215(c)(2)(D) requires that the ERO have Rules that provide for public comment and a balance of interests in developing a Reliability Standard, and membership should not thwart this requirement. Moreover, like SMUD, we believe that

[37] See section 215(c)(2)(C) of the FPA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

involving a wide range of viewpoints from interested parties benefits the Reliability Standard development process.

173. Finally, we find that the above discussion on ERO membership applies equally to membership in a Regional Entity. Each Regional Entity may determine whether membership is useful and appropriate in fulfilling its roles under EPAct and create Regional Entity Rules on membership. We reject FRCC's argument that, because Commission jurisdiction over a Regional Entity is limited to its delegated authorities, membership policies of a Regional Entity are not subject to Commission jurisdiction. As discussed above, membership provisions can affect whether a Regional Entity meets statutory criteria, including openness, due process, balanced decisionmaking and equitable allocation of reasonable dues and fees. The Commission intends to review a proposed Regional Entity Rule on membership and determine whether it is consistent with statutory criteria, including those described above.

ii. <u>Additional Non-statutory Criteria</u>

174. A number of commenters express concern regarding the technical and financial expertise of the ERO. For example, PG&E suggests that the Commission's regulations should ensure that the ERO will be knowledgeable to further ensure impartial and even-handed application of the Reliability Standards. To function effectively, the ERO must have a thorough understanding of the technical aspects of the industry, its financial requirements, and its applicable legal regulations, as well as of specific regional concerns. NiSource asks the Commission to clarify how it will assess an ERO or

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entity applicant's technical expertise when determining whether it has the ability to develop and enforce a Reliability Standard.

Commission Conclusion

175. It is critical that the ERO and each Regional Entity have adequate technical expertise. Pursuant to section 215(c)(1) of the FPA, an ERO applicant or a Regional Entity candidate must demonstrate in its application or request for approval of its delegation agreement that it has the ability to develop and enforce Reliability Standards for the Bulk-Power System. Accordingly, an ERO applicant or Regional Entity candidate must present evidence that it has, or has demonstrated access to, the necessary high level of technical expertise needed for carrying out these two functions. The applicant or candidate must present documented evidence that it has on staff, or has demonstrated experience in acquiring on a volunteer or other basis, the numbers of persons with the level of technical experience necessary to carry out the responsibilities of the ERO or a Regional Entity. The applicant or candidate must explain how it proposes to ensure appropriate kinds of technical, financial, and other expertise in the selection of board members, the recruitment of its staff, and the staffing of its committees and subordinate organizational structures. The ERO applicant must explain the extent to which it proposes to rely on the establishment of, and delegation to, Regional Entities to provide the numbers and levels of technical experts for carrying out its responsibilities.

176. Regarding the development of Reliability Standards, the ERO applicant or Regional Entity candidate must explain how it proposes to ensure the participation of technical experts in the initial development of a draft Reliability Standard for ERO

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

stakeholder consideration. It must explain how the technical merit of a proposed Reliability Standard would be maintained in any balloting or board process for approval of a draft Reliability Standard for proposal to the Commission.

177. Especially important is that the applicant or candidate must demonstrate that it has, or has the demonstrated ability to acquire or assemble, the technical expertise necessary for the enforcement of all Reliability Standards. Specifically, it must show that it has, or has experience with acquiring on a volunteer or other basis, the number of persons with the level of technical experience necessary to audit the users, owners and operators of the Bulk-Power System for compliance with the Reliability Standards, to investigate questions or allegations of noncompliance, and to determine the appropriate remedy or penalty. The applicant or candidate must explain how it proposes to divide these various areas of responsibility among its board and committee members, its permanent staff, its organizational members if any, industry volunteers, and any consultants or subcontractors.

178. Further, an ERO applicant that satisfies the requirements for independent governance, balanced decisionmaking, and appropriate ERO Rules should be impartial and even-handed in the application of Reliability Standards. Accordingly, we find that there is no need to create additional certification criteria as suggested by PG&E. Similarly, NiSource and others may address the technical qualifications of any ERO applicant and the factors by which to consider such qualifications, when an ERO application is filed.

e. Simultaneous Certification in Canada and Mexico

179. The NOPR proposed that ERO Rules must specify the appropriate steps, after certification by the Commission as the ERO, to gain recognition in Canada and Mexico. The NOPR states that the ERO can operate effectively only if it meets the requirements of all relevant regulatory authorities.[38]

Comments

180. Numerous commenters agree that the ERO must take steps to be recognized in Canada and Mexico. Some recommend that the Commission permit an ERO candidate to seek approval in Canada concurrent with approval in the United States. International Transmission suggests that recognition in Canada and Mexico should be a high priority of the ERO, once it is certified by the Commission. Detroit Edison comments that energy market disparities and related reliability concerns cannot be adequately addressed between the United States and Canada unless the ERO or its designated Cross-Border Regional Entity is required to have legal standing in Canada as the sole entity responsible for developing and enforcing Reliability Standards affecting reliability within its footprint.

181. Alberta submits that the establishment of an international ERO requires that an ERO applicant take appropriate steps to gain recognition in the relevant jurisdiction at the same time. APPA advocates that, although the statute requires the ERO to take steps to

[38] NOPR at P 41.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

gain recognition in Canada and Mexico after it is certified by the Commission, the Commission should, nevertheless, allow an ERO applicant or a proposed Regional Entity to seek approval in Canada and Mexico at the same time it seeks certification from the Commission. Others, such as CEA and BCTC, state that the Commission should encourage an ERO applicant to work with Canadian authorities in advance of its application for Commission certification. They believe that, consistent with the bilateral principles, advance discussions would ensure that the ERO applicant's governance structure reflects Canadian concerns and identify potential areas of disagreement.

Commission Conclusion

182. Section 215 of the FPA and our proposed rule require ERO candidates to propose "appropriate steps" to gain recognition in Canada and Mexico after certification by the Commission. The Commission does not view this requirement as precluding ERO candidates from seeking simultaneous certification in the United States, Canada and Mexico. Therefore, an ERO candidate may, and is encouraged to, seek recognition in Canada and, if appropriate, in Mexico, while pursuing Commission certification. Each ERO applicant or the certified ERO should keep the Commission informed about the status of its efforts to gain recognition in Canada or Mexico.

f. Periodic Performance Assessments

183. The certification regulations proposed in the NOPR would require the approved ERO to periodically submit an application to be recertified as the ERO.[39] The NOPR interpreted section 215 of the FPA as requiring the ERO to comply with the certification criteria on an ongoing basis, and that a violation of a certification criterion constitutes a violation of the FPA. The NOPR asked for comment regarding the appropriate cycle for periodic recertification and how far in advance the ERO should submit its application for recertification before its current certification period expires.

Comments

184. Virtually all commenters that discuss this issue support the notion that the ERO and each Regional Entity must meet the statutory criteria on an ongoing basis. APPA asserts that periodic recertification may keep the ERO diligent in carrying out its duties, if the process is not too frequent or elaborate. PG&E agrees that periodic recertification is important to ensure that the ERO is properly performing its duties, but is concerned that the process not dominate the ERO's time. However, most commenters question the need for a periodic recertification process in addition to the various other accountability processes proposed in the NOPR.[40] Some note that there is no specific statutory

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[39] Id. at P 42.

[40] E.g., Kansas City P&L, MidAmerican, FirstEnergy and MRO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

requirement for periodic recertification.[41] Others submit that any periodic recertification process could become a distraction and lead to inefficiency within the ERO and Regional Entities, especially during the early years as these organizations grapple with a multitude of start-up matters.[42] Further, some assert that periodic recertification could cause uncertainty among the owners, users and operators of the Bulk-Power System when it appears that an existing reliability organization may be close to losing its certification.[43] NERC submits that certification should not automatically lapse at the end of a periodic recertification cycle, rather certification should remain in place until the Commission makes a recertification decision. MRO and NERC comment that the Commission should coordinate recertification proceedings with Canadian regulators or seek their concurrence. Others, including APPA and ELCON, suggest that the Commission defer the decision on whether to require periodic recertification until a later stage after it acts on applications for ERO certification.

185. With regard to the timing of recertification, although NiSource suggests a recertification cycle once every three years, most commenters believe a longer cycle of

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[41] See, e.g., NRECA, MRO, Southern, SERC and FirstEnergy.

[42] See, e.g., National Grid, AEP, Southern, SERC, and MRO.

[43] See, e.g., APPA and LG&E Energy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

five or six years would provide needed stability.[44] Commenters suggest a range from 180 days to two years for the submission of a recertification application.

Commission Conclusion

186. The Final Rule does not adopt the periodic recertification process as proposed in the NOPR. Instead, we are mandating a regular performance assessment that requires the ERO to affirmatively demonstrate to the Commission that it satisfies the statutory and regulatory criteria for an ERO and is not only maintaining but improving the quality of its activities and those of the Regional Entities to which it has delegated such activities.[45] Although the ERO must be accountable to the public, stakeholders, and the Commission for good performance, we agree with commenters that a periodic recertification process would tax the resources of the ERO and take the focus away from its primary function of ensuring the reliability of the Bulk-Power System. We believe that the performance assessment process that we are adopting will enhance the Commission's oversight of the

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[44] See, e.g., Alcoa, the New York Companies, South Carolina E&G, NERC and TAPS.

[45] Accordingly, we are striking proposed 18 CFR 38.3(c) and 38.7(f) which read, respectively:

> (c) The approved ERO is required to periodically submit an application to be recertified as the ERO, in accordance with any requirements the Commission issues in this regard.
>
> (f) An approved Regional Entity shall be required to periodically submit an application to be re-approved as a regional Entity, in accordance with any requirements the Commission issues in this regard.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

ERO without the perceived destabilization of a periodic recertification requirement that implies the ERO may cease to exist unless it succeeds in a de novo certification application.

187. Pursuant to this new process at new section 39.3(c) of our regulations, the initial performance assessment will be required three years after ERO certification, and then every five years thereafter. New section 39.3(c) requires the ERO to affirmatively demonstrate that it satisfies on an ongoing basis the statutory criteria to qualify as an ERO. The Commission will review the periodic performance assessment and may require follow-up actions by the ERO to comply or improve compliance with the statutory and regulatory qualifications for the ERO, if the Commission determines that the ERO has not satisfied specific criteria. Moreover, the Commission views the performance assessment as an opportunity not only to demonstrate that the ERO has maintained, but also is improving, the quality of its activities and those of the Regional Entities to which the ERO has delegated such activities. The Commission expects the performance assessment to include regular and systematic measurement and reporting of the ERO's performance.

188. The ERO shall submit an assessment of its performance, after which the Commission will establish a proceeding with opportunity for public comment in which it will review the performance of the ERO. The ERO's assessment shall include: (1) an explanation of how it continues to satisfy the certification requirements; (2) recommendations by Regional Entities and other entities for improvement of the ERO's operations, activities, oversight and procedures, and the ERO's response; and (3) the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

ERO's evaluation of the effectiveness of each Regional Entity, recommendations for improvement of the Regional Entity's performance of delegated functions, and the Regional Entity's response to such evaluation and recommendations.

189. Regarding the first assessment item, the ERO should address its ability to develop and enforce Reliability Standards providing for an adequate level of reliability of the Bulk-Power System. The ERO should explain how effectively it enforced Reliability Standards, providing statistical information on its investigations, findings and assessments of penalties, on a regional and continent-wide basis. The ERO should also explain how it provided for fair and impartial procedures for enforcement of Reliability Standards and provided for openness, due process and balance of interests in developing Reliability Standards. The ERO should also address these matters as they pertain to the Regional Entities.

190. The burden will be on the ERO to conduct this assessment and affirmatively demonstrate that it satisfies the statutory criteria for the ERO and the quality of its activities. As part of this process, the ERO must entertain, consider and respond to outside recommendations for improvement from the Regional Entities and the owners, users and operators of the Bulk-Power System. The ERO must also evaluate the effectiveness of the Regional Entities to which it has delegated some of its functions and suggest how the Regional Entities might improve their performance.[46]

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[46] See 18 CFR 39.8, discussed infra.

191. As a result of its review of the performance assessment and public comments, the Commission will issue an order finding that the ERO meets the statutory and regulatory criteria or directing the ERO to comply with or improve compliance with the statutory and regulatory criteria for an ERO. Subsequently, if the ERO fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order as discussed below under Enforcement of Commission Rules and Orders, including, if necessary and appropriate, a proceeding to consider decertification of the ERO.

4. Funding of the Electric Reliability Organization – Section 39.4

192. In the NOPR, the Commission recognized that certainty regarding the funding of the ERO is essential for the stability and ultimate success of the organization, and accordingly, proposed a section of regulation text that provides requirements for funding and budget oversight of the ERO.[47] For discussion purposes in the Final Rule, we have grouped the funding related comments into several categories: budget and business plan, funding for statutory activities, role of the ERO in funding Regional Entities, funding consistency with the bilateral principles, payment of dues and funding transition plan, billing mechanics, and other funding matters.

[47] NOPR at P 99.

a. Budget and Business Plan

193. Subsections (a) and (b) of the proposed regulation on funding were intended to make the ERO accountable to the Commission for its budget for activities within the United States. They provided that the ERO must file a proposed annual budget and proposed annual funding request 130 days in advance of the beginning of each fiscal year. The Commission, after public notice and opportunity for comment, would issue an order accepting, rejecting, remanding or modifying the proposed ERO budget and business plan no later than sixty days before the beginning of the ERO's fiscal year.[48]

Comments

194. Most commenters agree that the Commission should review the ERO's budget to ensure adequate funding.[49] Exelon suggests that the annual ERO funding requirement for budget purposes should include amounts for all activities that are deemed necessary to achieve the purposes of section 215 of the FPA including amounts for those activities delegated to the Regional Entities. EEI agrees that the Commission should have to approve the annual ERO budget, as proposed in the NOPR, but argues that the review should be limited to the development of Reliability Standards and enforcement functions and should not include any other activities the ERO may choose to undertake nor should

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[48] Id.

[49] See, e.g., Exelon, Indianapolis P&L, LG&E Energy and NERC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

it include the overall ERO business plan.[50] Southern states that the Commission should conduct a general review of the ERO's budget and business plan to ensure that the ERO is maintaining spending discipline and not overspending on some activities at the expense of other activities, and that the Commission should defer to the ERO on matters pertaining to the budget and business plan because the ERO will possess the expertise to make the right decisions.

195. Others suggest tighter scrutiny over the budget out of concern that the new reliability program may lead to increased costs and, therefore, the Commission should ensure that any higher costs imposed on the electricity customers has a commensurate reliability benefit.[51] Ameren submits that a set of budget principles should be established for the ERO and Regional Entities. Indianapolis P&L states that the Final Rule should include a mechanism for stakeholders to provide input to ensure that the Commission has all the information it needs to make an informed decision on the ERO's budget. The Oklahoma Commission suggests that the notice and comment provisions for the ERO's annual funding request proposed in the NOPR also be applied to any funding request the ERO makes to the Commission outside of the annual budget process.

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[50] EEI envisions the ERO developing an annual budget for its Reliability Standards and enforcement activities, including those activities delegated to the Regional Entities to ensure that overall funding adequately supports the delegated Regional Entity functions. Specific funding and budget arrangements would be included in the delegation agreement.

[51] See, e.g., APPA, LG&E Energy and the New York Companies.

196. NERC asserts that the proposed regulations on funding be modified to provide for emergency funding to deal with extraordinary circumstances.

Commission Conclusion

197. The Commission generally adopts subsections (a) and (b) of the proposed regulation on funding as sections 39.4(a) and (b) with some additional specificity. We continue to believe that ERO funding certainty is essential for the stability and ultimate success of the organization and will review the ERO's budget and business plan to ensure that the ERO has adequate funding to carry out its responsibilities under section 215 of the FPA. We will not defer to the ERO on the budget or business plan as some suggest. However, we will not adopt budget principles in the Final Rule beyond the requirements specified in section 215(c)(2) of the FPA. We expect an ERO candidate to propose budget principles in its certification application and to consider the views of industry in developing its proposed budget and business plan.

198. Although our authority is limited to approving a business plan and budget as it pertains to statutory activities in the United States, the ERO must submit its business plan, entire budget, and organizational chart to the Commission, including those portions pertaining to activities in Canada and Mexico and any non-statutory activities. The complete business plan and the entire budget will inform the Commission as to what portion of the budget is expended upon the activities within the United States. Further they will provide the Commission with necessary information about any non-statutory activities, the source of their funding, and whether the pursuit of such activities presents a conflict of interest for the ERO. Additionally, section 39.4(c) of the regulation provides

for further stakeholder participation through the Commission's public notice and comment procedures. This will provide additional opportunity for stakeholders to express their views so that the Commission can make an informed decision on the ERO's budget proposal and business plan. The same notice and opportunity for comment would apply to any funding request the ERO makes to the Commission outside of the annual budget process.

199. As requested by NERC, the Final Rule adds a new subsection 39.4(d) that allows the ERO to request emergency funding. The new provision states:

> (d) On a demonstration of unforeseen and extraordinary circumstances requiring additional funds prior to the next Electric Reliability Organization fiscal year, the Electric Reliability Organization may file with the Commission for authorization to collect a special assessment. Such filing shall include supporting materials explaining the proposed collection in sufficient detail to justify the requested funding, including any departure from the approved funding formula or method. After notice and an opportunity for hearing, the Commission will approve, disapprove, remand or modify such request.

b. <u>Funding for Statutory Activities</u>

200. In the NOPR, the Commission indicated that paragraph (c) of the proposed section on funding intended to provide a Commission-approved mechanism for mandatory ERO funding in the United States.[52] However, rather than the Commission dictating a funding mechanism, the NOPR would have allowed an ERO applicant to propose a funding mechanism for Commission approval. Specifically, the proposed regulation stated that any person that submits an application for certification as the ERO must include a plan,

[52] NOPR at P 100.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

formula and/or methodology for the allocation and assessment of ERO dues, fees and charges; and the certified ERO may subsequently file with the Commission a request to modify the plan, formula and/or methodology from time-to-time at the ERO's discretion. Comments related to funding responsibility are discussed here in four groups: (1) general matters; (2) funding apportionment; (3) role of the ERO in funding the Regional Entities; and (4) additional comments regarding funding consistency with the bilateral principles.

i. General Funding Matters

201. Some commenters state that the NOPR generally provides a workable funding process to ensure that reasonable ERO costs are fairly recovered.[53] Some comment that, while section 215 of the FPA authorizes the ERO and the Regional Entities to collect funds only for actions taken under the statute, they are not necessarily precluded from pursuing other matters.[54] APPA submits that the Commission must make clear that the ERO and Regional Entities can fund activities which are not related to their duties under section 215 of the FPA and allocate the costs of those activities on a basis that is appropriate for such activity. EPSA asks the Commission to ensure that any funding proposal is developed in consultation with all affected users, owners and operators of the Bulk-Power System. Detroit Edison and WECC submit that no Regional Entity should be required to subsidize the delegated functions of any other Regional Entity.

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[53] See, e.g., EPSA, NERC and NiSource.

[54] See, e.g., APPA and NRECA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission Conclusion

202. We find that section 215 of the FPA provides for federal authorization of funding limited to the development of Reliability Standards and their enforcement, and monitoring the reliability of the Bulk-Power System. However, the ERO or a Regional Entity is not precluded from pursuing other activities, funded from other sources. We agree with commenters that any funding proposal should be developed in consultation with the users, owners and operators of the Bulk-Power System and that no Regional Entity should subsidize the functions of another Regional Entity.

ii. Funding Apportionment

203. In the NOPR, the Commission noted that the responsibility for NERC funding is based largely on "net energy for load." The cost of certain programs and tools that benefit only specific regions or parties would be assigned only to the beneficiaries of those programs or tools. In the NOPR, we indicated our belief that a funding method based on net energy for load meets the requirements of section 215(c)(3) of the FPA and is appropriate for the allocation and assessment of ERO dues, fees and charges.[55]

[55] NOPR at P 102.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Comments

204. Most commenters support use of a net energy for load-based funding apportionment for the ERO as well as the Regional Entity.[56] However, a few claim that this method will not apportion costs equitably and recommend other methods.[57]

205. PSE&G Companies states that the recovery of costs for the ERO and Regional Entities should be apportioned on the basis of net energy supplied to retail load because, as the ultimate beneficiaries of the reliability of the electric system, retail customers should bear the cost.

206. EPSA states that a net energy for load-based funding apportionment is appropriate because: (1) the statute requires funding by end-users; (2) net energy for load represents the aggregate annual energy consumption of end use customers in a particular region; and (3) since NERC currently uses this method, keeping it would avoid cost shifts. According to Chelan County, a net energy for load-based funding formula is consistent with the concept that load (rather than generation) should pay for reliability services that benefit end-users.

207. A benefit of the net energy for load approach is that it counts each kilowatt-hour of electric energy only once, and thus represents the fairest and most efficient method of allocating costs among end-users. Any other method may count energy more than once.

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[56] See, e.g., EPSA, PSE&G Companies, NASUCA, NARUC, NERC and Chelan County.

[57] See, e.g., The New York Companies, International Transmission and Entergy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

A net energy for load approach that charges based on energy consumed avoids such "double counting."[58]

208. Michigan Electric states that there should be no free riders when it comes to system reliability but points out that the ultimate payers of the ERO's costs will be retail customers, since charges assessed to any other users will eventually be flowed through to retail customers as part of the delivered cost of electricity. As such, the Commission must ensure that ERO costs are allocated on an equitable basis among retail customers and prevent multiple assessments regardless of the upstream entities involved. FRCC submits that the NOPR's focus on different types of users of the Bulk-Power System may lead to two or more entities passing on such costs to the same customers.

209. The ISO/RTO Council argues that a transmission facility owner or operator should not be allocated a share of ERO costs, except to the extent that it also acts as a load-serving entity. Otherwise, an end user could pay twice for the reliability functions of the ERO and the Regional Entities once through charges assessed against an RTO, ISO, independent transmission company, or transmission function of a vertically integrated company, and a second time through an assessment against its load-serving entity. To avoid this potential double count, an end user should be assessed through its load-serving entity.[59]

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[58] See, e.g., NASUCA and NRECA.

[59] See, e.g., Ohio Commission, ISO/RTO Council and Alcoa.

210. As an independent transmission owner, International Transmission expresses concern about a system that treats both a local utility using an independent transmission owner's system and the transmission owner itself as "beneficiaries" of reliability that need to be charged accordingly.

211. The New York Companies state that net energy for load, particularly in areas of the country where suppliers and load represent different organizations, will not work, as it would allow suppliers and perhaps other organizations that are connected to the Bulk-Power System to avoid paying their fair share of ERO and Regional Entity membership fees.

212. As an alternative to net energy for load-based funding, International Transmission suggests that the ERO adopt the transmission MWh usage model that the Commission applies to assess annual dues from jurisdictional public utilities. However, MISO Transmission Owners oppose this because it would result in a disproportionate assessment against entities that belong to an RTO. Indianapolis P&L suggests apportioning the ERO funding responsibility through an assessment on: (1) load-serving entities based on the number of their customers; (2) independent transmission companies based on their transmission line miles; and (3) independent power providers based on their sales volume.

Commission Conclusion

213. Commenters largely agree that a funding apportionment method based on net energy for load is appropriate. We find this funding method to be a fair and reasonable method that minimizes the possibility of "double-counting." However, we will not

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

codify any particular formula in our regulations because some adjustment in the formula may be needed in the future without the need to alter the rule. Therefore, we do not rule out any other apportionment method that can be shown to be fair and reasonable. Alternative funding apportionment methods suggested by a few commenters appear to garner limited support, can be more complex to implement, or raise the issue of double counting.

214. Section 39.4(a) of our regulations provides the ERO applicant the flexibility to propose a formula or method for the allocation and assessment of ERO costs to paying entities, as well as setting out member dues, fees and service charges. However, any funding proposal by an ERO applicant must ensure that costs are allocated equitably consistent with section 215(c)(2)(B) of the FPA. In addition, any funding proposal must ensure that cross-subsidization is minimized.

c. Role of the ERO in Funding the Regional Entities

215. The NOPR asked what, if any, responsibility or involvement the ERO should have regarding funding of Regional Entities.[60] In addition, the NOPR requested comments on whether the proposed regulations on funding and budget oversight for the ERO should be extended to the Regional Entities.[61]

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[60] NOPR at P 84.

[61] NOPR at P 103.

i. ERO Responsibility for Regional Entity Funding

216. Some commenters advocate ERO oversight of Regional Entity funding. NERC and Exelon submit that, since the ERO is ultimately responsible for the effective enforcement of Reliability Standards, it must have the authority to review and approve each Regional Entity's budget to ensure that each has the resources needed to meet its assigned responsibilities. The ERO must include each Regional Entity's budget in the ERO's annual funding submission to the Commission and other appropriate regulatory authorities. The supporting materials should be sufficient to allow the ERO to defend the Regional Entity budgets as part of its budget submittal to the Commission.

217. MRO suggests that the matter of funding the Regional Entities should be left to negotiation between the ERO and Regional Entities and detailed in the delegation agreements. SERC submits that the ERO should not distinguish between Interconnection-wide and other Regional Entities when it reviews a Regional Entity's budget and funding.

218. In contrast, WECC submits that the ERO should not substantively review the budget of an Interconnection-wide Regional Entity. Alternatively, if the ERO does review the budget, the Regional Entity should be entitled to a rebuttable presumption of reasonableness similar to that applicable to a proposed Interconnection-wide Reliability Standard. Otherwise, extensive ERO review would result in an inefficient and uncertain budget and funding process that would cause unnecessary delay. Further, extensive ERO

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

review could create conflicts if WECC's international members do not recognize the ERO's authority to review the WECC budget.[62]

219. Others comment that stakeholders and users, owners and operators of the Bulk-Power System in a Regional Entity should be solely responsible for Regional Entity funding decisions.[63] The New York Companies assert that it would not be appropriate, for example, for the ERO to have the ability to withhold funding for a Regional Entity because the ERO disagrees with a position the Regional Entity has taken with respect to a proposed Reliability Standard; however, Regional Entity funding should be subject to Commission oversight to ensure that costs across regions are comparable. PSEG Companies submits that the ERO's role should be limited to collecting the regional requests and filing them as a package together with the ERO request to the Commission.

220. Some commenters submit that, in addition to approving each Regional Entity budget, if a Regional Entity is acting on behalf of the ERO and performing delegated enforcement tasks, the ERO should fund the Regional Entity for carrying out such delegated functions. The ERO, however, should not be responsible for funding any other functions that a Regional Entity performs.[64] Detroit Edison states that a Regional Entity should be permitted to collect funds from its members without Commission involvement.

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[62] See also Western Governments.

[63] See, e.g., LADWP and SoCalEd.

[64] See, e.g., ELCON and Michigan Electric.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

221. Some commenters contemplate that the Regional Entities should fund the ERO. According to NiSource, currently NERC develops a budget and, based on a set of formulas, allocates its funding requirements among the ten regional reliability councils. NERC funding then becomes a line-item in each regional reliability council's budget. Each regional reliability council allocates its funding requirements among its members. NiSource says ERO funding should follow the same general format with the Regional Entities funded by the users of the system for which the Regional Entity is responsible. A portion of the ERO budget would then be allocated to and funded by each Regional Entity.

222. Hydro One points out that, ultimately, end-users will fund the ERO by remitting fees to the Regional Entity. PacifiCorp submits that the ERO should compensate a Regional Entity if it develops an operational tool for itself at its own cost, but other Regional Entities benefit from that tool.

223. The City of San Antonio indicates that ERCOT is a state-funded institution and any funding mechanism that the Commission decides for the ERO should not conflict with the Texas state statutory funding mechanism for ERCOT. It is concerned that, in the event ERCOT becomes a Regional Entity, a fee from the Regional Entity to fund the ERO would alter the Texas state statutory funding mechanism for ERCOT.

ii. Commission Oversight of Regional Entity Funding

224. While many commenters support extending the Commission's ERO funding regulations to the Regional Entities,[65] a few oppose this approach. Other commenters suggest extending the funding regulations to those functions that the ERO delegates to a Regional Entity or funding addressed in a delegation agreement.[66] NARUC and NERC comment that the regulations related to funding of Regional Entities should mirror those of the ERO to the extent practicable or should be specifically defined in the Regional Entity delegation agreement. Southern suggests that the ERO, not the Commission, should review each Regional Entity's proposed budget for delegated activities. PacifiCorp submits that each Regional Entity should be able to develop its own budget to reflect local needs, but the ERO should consolidate and submit all of the Regional Entity budgets as a joint filing to the Commission. The ERO should not be the entity with budget authority over an Interconnection-wide Regional Entity.[67]

225. FRCC asserts that a Regional Entity should be responsible for preparing its budget and providing support for it. Regional Entity budgets should be combined with the ERO budget for convenience in the submission of a complete, single annual reliability budget to the Commission; however, the ERO should not try to integrate the Regional Entity

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[65] See, e.g., ERCOT, APPA, AEP, Exelon, NARUC, NERC FRCC and TAPS.

[66] See, e.g., NPCC and EEI.

[67] See, e.g., the City of Seattle.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

budgets with each other or the ERO's budget into a consolidated budget. Although some ERO review of the reasonableness of the Regional Entity budgets and their consistency with the ERO budget may be appropriate, unnecessary review and consolidation would not serve a useful purpose, and would only make the budgeting process unduly lengthy and burdensome.

226. In FRCC's view, the Commission's review of Regional Entity budgeting and funding process should be limited to the delegated functions carried out by a Regional Entity, as many of the other functions in which a Regional Entity may engage are not jurisdictional to the Commission.

Commission Conclusion

227. Since the ERO is the primary entity responsible under section 215 of the FPA for the development and enforcement of Reliability Standards, we find that the ERO should fund the Regional Entities as well as approve their budgets, under the Commission's oversight. The ultimate success of the ERO will depend on whether a Regional Entity has adequate funding to carry out its delegated responsibilities. The ERO must have oversight to ensure that Regional Entities are adequately funded to accomplish their delegated functions. This oversight, however, should be limited to the delegated activities that they perform pursuant to their delegation agreements. To implement this, we are including the following text at the end of subsection 39.4(b):

> The annual Electric Reliability Organization budget shall include line item budgets for the activities of each Regional Entity that are delegated or assigned to each Regional Entity pursuant to section 39.8 of the Commission's regulations.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Accordingly, the ERO must exercise budgeting oversight over the Regional Entities.

228. Each Regional Entity must submit its complete business plan, entire budget and organizational chart to the ERO for it to submit to the Commission. The complete business plan and the entire budget will provide the Commission with necessary information about any non-statutory activities, the source of their funding, and whether the pursuit of such activities presents a conflict of interest for the Regional Entity. For a Cross-Border Regional Entity, this information will also inform the Commission as to what portion of the budget is expended upon activities within the United States.

229. Any funding that is approved and provided by the ERO to a Regional Entity would be limited to a Regional Entity's costs related to the delegated functions. The ERO must determine, at a minimum, whether each Regional Entity's proposed budget is adequate to carry out the functions delegated to it. While a Regional Entity will be able to perform other activities that do not conflict with its delegated functions, periodic financial audits will be required to ensure that any ERO-approved funding is appropriately expended for delegated functions. ERO candidates should propose a plan for the collection of sufficient funds for delegated activities in their application for certification. The ERO must make a recommendation to the Commission on this matter. A Regional Entity should arrange funds for its other activities on its own. Procedures for ERO review of a Regional Entity's budget should be addressed in the delegation agreement.

230. The Regional Entity is responsible for supporting its budget presentation to the ERO because it is responsible to the ERO for carrying out delegated ERO responsibilities, whether or not it spans an entire Interconnection. Therefore, we direct

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the ERO and each Regional Entity to ensure that the delegation agreement lists all the statutory activities that they intend the Regional Entity to undertake on behalf of the ERO.

d. Funding Consistency with the Bilateral Principles

231. In the NOPR, the Commission noted that the bilateral principles include several funding principles: (1) a principle specifying that net energy for load should be the primary basis upon which the costs of the ERO are assigned and that costs for one region or entity should be directly assigned to that region or entity; (2) a principle specifying that funding mechanisms, budget direction and budget levels should reflect consultations with appropriate stakeholders and authorities in each country; and (3) a principle specifying that the appropriate authorities in each country should be responsible for approving and ensuring cost recovery by the ERO and Regional Entities within their respective jurisdictions in a timely manner. The NOPR inquired as to whether the Final Rule should address such funding issues in detail or whether the ERO and Cross-Border Regional Entities should propose resolution of these matters at a later time.[68]

Comments

232. There is strong support for following the bilateral principles on funding matters but not necessarily for incorporating them into the Final Rule.[69] Many commenters

[68] NOPR at P 103.

[69] See, e.g., AEP, APPA, Alberta, ELCON, NERC and Ontario IESO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

prefer that the ERO and Cross-Border Regional Entities develop their own international funding proposals. APPA notes that it participated in the development of the bilateral principles and would have no objection to the Commission including these principles, such as net energy for load-based funding, in the Commission's Final Rule. ERCOT maintains that the Final Rule should specify that the costs of the ERO should be assigned to the participating nations on a net energy for load basis; however, costs incurred by the ERO for operational tools such as NERC's current Interchange Distribution Calculator should be assigned only to those regions utilizing the tool. In the case of expenses incurred by a Cross-Border Regional Entity, the Commission should approve the share of expenses incurred within the United States, while the relevant Canadian and Mexican authorities should decide whether to approve the expenses assigned to parties within its borders. Other commenters also submit that it is appropriate for the ERO and Regional Entities to propose such funding mechanisms in their applications for certification or delegation agreement approval in consultation with appropriate regulatory authorities in other countries in accord with the bilateral principles.[70]

233. MRO comments that the Commission should allow the ERO and the Cross-Border Regional Entities to address such international funding-related details in a manner that best suits each individual situation. Others contend that the Final Rule should not specify a detailed funding mechanism, in part because Canadian regulators also have to approve

[70] See, e.g., NERC and Ontario IESO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the mechanism for their jurisdictions.[71] Funding mechanisms, budget direction and budget level should be allowed to reflect ERO consultation with stakeholders and the appropriate authorities in each country, as the recovery of costs in Canada related to the ERO and Cross-Border Regional Entities must be determined by the various jurisdictions in Canada.[72] Since regulatory authorities have different views on how costs should be recovered within their jurisdiction, the Final Rule should not include a provision specifying what other jurisdictions should do.[73]

Commission Conclusion

234. We agree with commenters that the bilateral principles provide a good starting point for funding guidelines in the continental North American context. We also agree with the need to provide the ERO candidates and Cross-Border Regional Entities with enough flexibility to develop funding details with the appropriate regulators of all the participating nations. Our review and approval of ERO and Cross-Border Regional Entity funding mechanisms will be limited to their application in the United States. However, as explained above, we expect that the ERO or a Cross-Border Regional Entity will submit to the Commission and other appropriate regulators its entire business plan for the whole organization, its entire budget, its full funding mechanism, and budget

[71] See, e.g., Nova Scotia, Santee Cooper and NPCC.

[72] See, e.g., Alberta.

[73] See, e.g., NARUC and NERC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

allocation. Complete funding information is necessary so that regulators can assess the appropriateness of cost share and benefits share for each country or region.

e. Payment of Dues and Funding Transition Plan

235. The NOPR proposed that all entities within the Commission's "reliability" jurisdiction, as set forth in section 215(b) of the FPA, must pay the ERO's assessment of dues, fees and charges in a timely manner.[74] The NOPR also provided that any person who submits an application for certification as the ERO may include a plan for a transitional funding mechanism that would allow it, if certified as the ERO, to continue existing operations without interruption as it transitions from one funding method to another.[75] The proposed maximum duration of any proposed transitional funding mechanism would not exceed eighteen (18) months from the date of certification.

Comments

236. NERC agrees that certainty regarding the funding of the ERO is essential for the stability and ultimate success of the organization in carrying out its mission, particularly since the ERO is expected to be nonprofit. Commenters generally agree on the need for a funding transition plan. For example, Exelon supports a strong and stable funding source to support the reliability efforts to be carried out by the ERO. MRO asserts that the

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[74] NOPR at P 100.

[75] Id. at P 101.

optimal time to achieve certainty of funding for the ERO is during the certification process.

Commission Conclusion

237. No commenter objects to our proposal that entities within our jurisdiction must pay the ERO's assessment of dues, fees and charges in a timely manner. Such timely payment is necessary for the continuity of ERO activities and a reasonable requirement of those who benefit from Bulk-Power System reliability. Accordingly, in section 39.4(e) of the Final Rule, we adopt the substance of the proposed regulation text requiring jurisdictional entities to pay the ERO's assessment of dues, fees and charges in a timely manner. In section 39.4(f), we adopt, with minor non-substantive revision, the proposed regulation regarding transitional funding as to provide funding certainty during a period when the industry transitions from a voluntary organization to an organization for mandatory compliance with enforceable Reliability Standards.

f. Billing Mechanics

238. In the NOPR, the Commission noted that section 215 of the FPA does not contain any specific requirements regarding the revenue collection for the ERO, other than specifying that the Commission may certify an ERO if it determines that such ERO, inter alia, has established Rules that allocate equitably reasonable dues, fees, and other charges among end-users.[76]

[76] Id. at P 99.

Comments

239. Some commenters state that, with a few modifications, the current method of funding NERC and the regional reliability councils should be carried over to the funding of the ERO and the Regional Entities; however, in a change from current practice, all users of the Bulk-Power System should be directly allocated a share of a Regional Entity's costs, not just the Regional Entity members.[77] It is unnecessary for the ERO and Regional Entities to be financed directly by retail load and/or the entities that serve such load (such as distribution cooperatives), since NERC and the regional reliability councils are generally not funded in this manner today. Making such a change would be administratively disruptive. South Carolina E&G states that the ERO and a Regional Entity should jointly ensure that the fees assessed to end-users will fund their activities.

240. Allegheny expresses concern that the cost of operating and maintaining the ERO will be a non-discretionary cost over which industry participants will have no control. Consequently, ERO costs should fall on retail consumers. The cost of operating the ERO will be like a tax, yet neither the ERO nor the Commission has the ability to levy a direct charge for ERO costs on an individual end user. The task before the Commission and the ERO will be to design a mechanism that allows ERO costs to be charged in an equitable manner to those entities over which the Commission has jurisdiction and can be passed on by local distribution companies to an end user. However, a distribution company may

[77] See, e.g., NiSource, Exelon, Entergy and MidAmerican.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

be subject to a retail rate moratorium and the Commission cannot provide a clear and unequivocal determination of preemption that will enable a distribution company to recover ERO costs from its retail ratepayers.

241. NASUCA and ELCON recommend that the ERO funding mechanism should be submitted to the Commission in the form of a tariff to be formally approved. ELCON asks that such a net energy for load-based tariff be levied on Balancing Authorities. Certain commenters caution that the development of a funding mechanism should recognize the possibility of trapped costs when there is a lag between cost incurrence and the reflection of such costs in the rates of transmission owners.[78] The Commission should seek an alternative such as an automatic trackers or true-up mechanism to minimize the risk of trapped costs. The Commission should confirm that transmission owners will be permitted to recover ERO costs that they are assessed and avoid adopting any funding mechanism that requires transmission owners to assess charges on the ERO's behalf where other transmission owners have relinquished their wholesale billing function due to RTO/ISO membership. In this regard, Michigan Electric suggests that the Commission not adopt a mechanism that requires “Balancing Entities” as currently defined by NERC to perform such a billing function.

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[78] See Michigan Electric and International Transmission. Michigan Transmission supports inclusion of a formula-based process as one of the alternatives the ERO may propose as part of its funding mechanism.

Commission Conclusion

242. The issue of billing mechanics associated with the collection of funds refers to who receives invoices from the ERO or Regional Entity and who collects the monies from end users. Billing mechanics may depend on funding responsibility, for example, whether net energy for load is adopted and whether generators, large industrial customers, and others are billed directly by the ERO or if all invoices go only to balancing entities (control areas) or only to all load serving entities. Accordingly, cost allocation and cost responsibility questions should be addressed first by the ERO and submitted together with a proposal for revenue collection for Commission approval. A candidate ERO's certification application should provide at least enough detail for the Commission to assess the general plan. Accordingly, we direct the ERO applicant to present a detailed proposal for billing mechanics in its application.

g. Other Funding Matters

243. NASUCA recommends requiring the ERO and Regional Entities to use the Uniform System of Accounts for reasons of consistency.

244. NiSource submits that once the Commission approves a mechanism, it should limit the frequency of modifications in the approved mechanism. CREPC suggests that the regulations should require that any Regional Entity that spans an entire Interconnection must file its proposed budget with its Regional Advisory Body at the same time it files with the Commission and the ERO, and further require that the ERO must file its proposed budget with the all of the Regional Advisory Bodies at the same time it files with the Commission.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

245. CREPC also recommends that the Commission require each Regional Entity to fund the relevant Regional Advisory Body.

Commission Conclusion

246. With regard to NASUCA's suggestion, we find that consistency of financial responsibility between the ERO and a Regional Entity is desirable. However, we decline to decide in this Final Rule that the Uniform System of Accounts designed for public utilities is best for these non-utility entities. Rather, we will allow the ERO flexibility to develop a reasonable and consistent system of accounts, with a level of detail and record keeping comparable to the Uniform System of Accounts and sufficient to allow the Commission to compare each Commission-approved ERO fiscal year budget with the actual results at the ERO and Regional Entity level. The pro forma delegation agreement must specify that a Regional Entity must also follow the ERO's prescribed system of accounts.

247. With respect to NiSource's comment, we expect that requests to modify the approved funding mechanism will be infrequent because such change may be controversial and disrupt the ERO's ongoing funding.

248. We find that it is not necessary to provide in our regulations funding of a Regional Advisory Body. Such bodies are voluntary organizations with members to be appointed by the Governor of each participating state or province. Each Regional Advisory Body is responsible for developing its own funding means.

5. Reliability Standards – Section 39.5

249. Consistent with section 215(d) of the FPA, the proposed regulations directed the ERO to file a proposed Reliability Standard or modification to a Reliability Standard with the Commission for review. The Commission may approve a proposed Reliability Standard or modification to a Reliability Standard if it determines that the Reliability Standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest. In its review, the Commission will give due weight to the technical expertise of the ERO or a Regional Entity organized on an Interconnection-wide basis with respect to a Reliability Standard to be applicable within that Interconnection, except that the Commission may not defer to the ERO or a Regional Entity with respect to the effect of a Reliability Standard on competition.

250. The NOPR provided that the Commission shall remand a Reliability Standard that it disapproves in whole or in part and, when remanding, may set a deadline by which the ERO must submit a proposed revision to the Reliability Standard. The proposed rule stated that the Commission may direct the ERO to submit a proposed Reliability Standard that addresses a specific matter. Further, the Commission may remand a previously-approved Reliability Standard if it determines that it does not satisfy the legal standard of review.

a. Reliability Standard Development by the ERO and Regional Entities

i. Reliability Standard Development by the ERO

251. The regulations proposed in the NOPR directed the ERO to consider and develop Reliability Standards and modifications to Reliability Standards, applicable to the entire Bulk-Power System or to a particular region or Interconnection.

252. Though the comments on this section address a broad range of issues, many focus on the proper scope of the subject matter of the Reliability Standards, the role of the ERO and others in Reliability Standard development. For example, NRECA emphasizes that any Reliability Standard developed by the ERO must be limited to addressing reliability issues; the Commission must not use its new authority to impose economic regulation on a nonpublic utility.

253. The ISO/RTO Council comments that Reliability Standards developed by the ERO should reflect the "what" not the "how" of reliability. By this they mean that the ERO's role should be to develop a Reliability Standard specifying "what" is necessary to preserve reliability and impose a penalty for violation of such a Reliability Standard, whereas "how" such a Reliability Standard is implemented should be left to others, such as control area operators and system planners. Reliability Standards should apply equally well in areas with organized markets and those without organized markets.

254. The Missouri Commission suggests that, although neither the ERO nor the Commission has been granted authority to order the construction of new generation or transmission capacity, the ERO should develop and the Commission should approve

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

voluntary planning standards—a traditional function of NERC and the regional reliability councils. These voluntary planning standards could then be enforced by the states. Trexco encourages the Commission to put a greater emphasis on long-term plans because an emphasis on day-to-day operations could increase future risk to the grid. Further, Reliability Standards should provide incentives for enhancement of transmission capacity.

255. International Transmission comments that the ERO should establish and implement strong Reliability Standards that do not reflect the lowest common denominator. Strong Reliability Standards would also highlight the need to expand transmission infrastructure and promote the deployment of advanced grid technologies.

256. LADWP states that Reliability Standards should be clear, unambiguous, practicable, but sufficiently flexible to allow the system operator discretion in dealing with an emergency condition. Reliability Standards that are overly prescriptive or too rigid would inhibit, rather than facilitate, an operator's ability to respond rapidly in an emergency. For example, under extreme conditions such as an earthquake, there may be an occasion when a system operator may have to permit, momentarily, a frequency level lower than that allowed by a Reliability Standard to avoid tripping generating units and in turn avoid a blackout. In addition, the Final Rule and Reliability Standards should specify the roles of, and the actions to be taken by, the ERO and a Regional Entity in the event of an emergency. After the emergency has passed, the ERO Rules and Regional Entity Rules should allow for stakeholder review of the actions taken and of the Reliability Standards themselves.

257. WECC asks the Commission to revise the proposed regulation to clarify that a Regional Entity has the right to consider and develop Reliability Standards or modifications. WECC asserts that this right is absolutely clear from section 215(e)(4) of the FPA where the legislative language requires the Commission to "issue regulations authorizing the ERO to enter into an agreement to delegate authority to a regional entity for the purpose of proposing reliability standards to the ERO." Such a right is only implied in the NOPR. WECC asks that the Final Rule make this explicit by adding the following text at the end of the first sentence of paragraph (a) of the Commission's proposed regulations on Reliability Standards: "Regional Entities may also consider and develop Reliability Standards or modifications to Reliability Standards to be applicable to the entire Bulk-Power System or a particular region or Interconnection for submission to the ERO for approval (subject to applicable presumptions) as ERO-proposed standards." WECC argues that the addition of this sentence would avoid any ambiguity regarding a Regional Entity's right to propose a Reliability Standard and would provide proper context to the Commission's regulations in subsections (b)(2) and (d) of the Commission's proposed regulations on Reliability Standards.

Commission Conclusion

258. The Commission adopts the substance of the proposed regulation. Any proposed Reliability Standard development process must ensure that any Reliability Standard is technically sound and the technical specifications proposed would achieve a valuable reliability goal. The process must also: (1) be open and fair; (2) appropriately balance the interests of stakeholders; (3) include steps to evaluate the effect of the proposed

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard on competition; (4) meet the requirements of due process; and (5) not unnecessarily delay development of the proposed Reliability Standard.

259. We agree with NRECA that the Reliability Standards should not be used to impose economic regulation on entities that are not jurisdictional to the Commission for their rates, terms and conditions. However, each user, owner and operator of the Bulk-Power System will be expected to comply with Reliability Standards. Pursuant to section 1241 of EPAct,[79] the Commission will allow recovery of all costs prudently incurred to comply with the Reliability Standards.

260. While we are sympathetic to ISO/RTO Council's suggestion that, in general, a Reliability Standard should address the "what" and not the "how" of reliability and that the actual implementation of a Reliability Standard should be left to entities such as control area operators and system planners, in certain limited situations there may be a good reason to leave implementation practices out of a Reliability Standard. In other situations, however, the "how" may be inextricably linked to the Reliability Standard and may need to be specified by the ERO to ensure the enforcement of the Reliability Standard. For some Reliability Standards, leaving out implementation features could: (1) sacrifice necessary uniformity in implementation of the Reliability Standard;

[79] We note that section 1241 of EPAct (Transmission Infrastructure Investment) adds a new section 219 to the FPA which mandates that not later than one year after enactment of section 219, the Commission establish, by rule, incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce by public utilities for the purpose of benefiting consumers by ensuring reliability and reducing the cost of delivered power by reducing transmission congestion.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

(2) create uncertainty for the entity that has to follow the Reliability Standard; (3) make enforcement difficult; and (4) increase the complexity of the Commission's oversight and review process. Accordingly, we leave it to the ERO to develop proposed Reliability Standards that appropriately balance reliability principles and implementation features.

261. In response to the Missouri Commission's comment regarding planning standards, we do not believe it is possible or desirable to try to develop generic guidelines on planning roles in this proceeding.

262. We agree with LADWP that the Reliability Standards should be clear, unambiguous, practicable, and must also address emergency conditions. However, specifying the roles and actions to be taken by the ERO and the Regional Entity in the event of an emergency, including the post-review of the operator actions, is outside the scope of this proceeding. We expect the ERO to develop proposed Reliability Standards and these may address the roles of various entities in an emergency.

263. In response to WECC, we clarify that a Regional Entity may consider and propose a Reliability Standard or modification for its region or the continent-wide Bulk-Power System to the ERO.

ii. Due Process in Reliability Standard Development

264. Consistent with the statute, the NOPR proposed that an ERO applicant must have established ERO Rules[80] that provide reasonable notice and opportunity for public comment, due process, openness, and balance of interests in developing a proposed Reliability Standard, and otherwise exercising ERO duties.[81]

Comments

265. EEI states that the ERO must develop a Reliability Standard using a process that meets the statutory requirements for due process, openness and balance of interests. TAPS, EEI, and others commenters suggest that ANSI accreditation is one way to satisfy the openness requirement. Some favor ANSI accreditation, and one urges that ANSI certification should be prima facie evidence that the ERO's Reliability Standard development process meets the requirement that the ERO establish Rules that provide reasonable notice and opportunity for public comment, due process, openness, and balance of interests in developing Reliability Standards, and otherwise exercising its duties, and note that an ANSI-accredited process does not require participants to be

[80] As noted in the NOPR, the ERO Rules include the bylaws, rules of procedure and other organizational rules and protocols of the ERO, and are distinguishable from the ERO's Reliability Standards. NOPR at P 30.

[81] Id. at P 41.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

members.[82] NRECA recommends that the Final Rule expressly codify that the ERO must have ANSI accreditation for its Reliability Standard development process.

266. EEI suggests that an ANSI-certified process is one means to satisfy the statutory requirements, but does not rule out the possibility of a different "rigorous process." Massachusetts Commission and other commenters strongly urge that the ERO be required to use the ANSI-certified Reliability Standard development process currently used by NERC. Indianapolis P&L notes that this is important for maintaining technical best practices. South Carolina E&G states that ANSI certification would ensure openness, consensus, and due process.

267. With regard to openness in the Reliability Standard development process, some commenters favor NERC's present nine representative stakeholder sectors and registered ballot body process as a workable template to follow.[83]

Commission Conclusion

268. As noted above, the Final Rule adopts the NOPR's requirement that an ERO application must include ERO Rules that provide for reasonable notice and opportunity for public comment, due process, openness, and balance of interests in developing a Reliability Standard and otherwise exercising its duties. The ERO should propose such a process in its certification application in accordance with section 39.3(b)(2)(iv).

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[82] See, e.g., EEI, APPA, EPSA, South Carolina E&G and SERC.

[83] See, e.g., SMA and ELCON.

269. Although we are not requiring that the ERO adopt an ANSI-certified approach to meet all of the requirements of section 39.3, we find that ANSI-accreditation is one reasonable means of doing so. We agree with EEI that a process like the ANSI-certified process would ensure openness and balance the interests of stakeholders. However, we are concerned about the time it may take to develop a Reliability Standard under the ANSI-certified process. The ERO applicant should address in its application the timetable for developing a proposed Reliability Standard under an ANSI-certified or other process, including the timetable for developing a proposed Reliability Standard that is urgently needed. Moreover, the ERO applicant should also propose a process for modifying or replacing a Reliability Standard (even if interim in nature) in the event that the Commission orders the ERO to modify a Reliability Standard.

270. Regardless of the method proposed by an ERO candidate to ensure due process, openness, and balance of interests in developing a Reliability Standard and otherwise exercising its duties, the ERO application must describe how the ERO applicant would provide for fair representation of all views in its process for developing a proposed Reliability Standard.

iii. <u>Regional Uniformity and Variation of a Standard</u>

271. In the NOPR, the Commission proposed that there should be uniformity of Reliability Standards among regions unless a difference is necessary for reliability. The Commission proposed in paragraph 46 of the NOPR that there should be a greater level of uniformity among regional Reliability Standards for Regional Entities not organized on an Interconnection-wide basis. The NOPR proposes an interpretation of the FPA that

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

any regional Reliability Standard proposed to the ERO by a Regional Entity would, upon approval by the Commission, become a variance of an ERO Reliability Standard, not a Regional Entity Reliability Standard.[84]

272. In responding to the NOPR, commenters and participants in the Commission's technical conferences on Electric Reliability Standards refer to various types of regional difference. For example, some commenters refer to a regional difference as a Reliability Standard that is essentially the same as a continent-wide Reliability Standard but is more stringent. Others refer to an aspect of a continent-wide Reliability Standard that is applicable only in one region or a group of regions, such as a difference that exempts a particular region from some aspect of a Reliability Standard. Others refer to a difference that permits a region to fulfill some component of the Reliability Standard in an alternate manner. There is also a part of a continent-wide Reliability Standard that contains a measure or performance criterion that is left blank in the Reliability Standard for each region to fill in. Some commenters distinguish two other types of regional difference, a Reliability Standard for a region or group of regions on a matter for which there is no comparable continent-wide Reliability Standard and or an addition to a continent-wide

[84] NOPR at P 80.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard for a region or group of regions for which there is no comparable continent-wide Reliability Standard addition. There may be others.[85]

273. In this Final Rule, we do not attempt to distinguish or rule separately on these various types of regional difference but refer to them generally as regional differences.[86]

274. It is not clear in every comment which type of regional difference is being referred to, but where we believed the meaning is clear we used the terminology above in summarizing comments.

Comments

275. Commenters offer a range of views on the need for uniformity of Reliability Standards among regions and the need for regional differences. Many commenters cite the benefits of uniform continent-wide Reliability Standards. Others assert that Reliability Standards should be tailored to reflect each region's unique characteristics. Others, however, see a middle ground, explaining that continent-wide Reliability Standards could be supplemented by regional differences.

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[85] Some participants in our technical conferences also mentioned an "entity variance," referring to a difference in some aspect of a Reliability Standard that would apply to a particular entity that is smaller than a region, such as an RTO or ISO.

[86] We note that some commenters call for greater flexibility for a regional requirement that is not itself a Reliability Standard but is a region's specification of how to comply with a continent-wide Reliability Standard within the region. Some refer to this as a "regional criterion." Our discussion below of requirements regarding uniformity and regional differences does not necessarily apply to such "regional criteria" that a region may seek to make mandatory under section 215 of the FPA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

276. Xcel Energy believes that a single uniform set of North American Reliability Standards, without regional differences, should be the goal. Alcoa comments that the Commission should view regional variances with skepticism.

277. EPSA comments that lack of uniformity in Reliability Standards creates the potential for conflicts, thus increasing the cost of electricity to consumers. In supporting regional uniformity, Hydro One observes that the liberalization of energy markets in recent years has been accompanied by a proliferation of new entities. The coordination of reliability and commercial interests of these entities is becoming complex and conflicting and has resulted in inconsistent roles and responsibilities.

278. Western Governments and others comment that, because there are physical, economic, and institutional differences between the Western Interconnection and the Eastern Interconnection, Reliability Standards should not be standardized for the entire North American continent[87] Western Governments adds that, because decisions are best made by those closest to the issues and who bear the consequences of the decisions, the Commission should defer to the Western Interconnection in setting and enforcing Reliability Standards. The California Commission adds that WECC, in collaboration with other regional organizations, has a great deal of experience, and has already demonstrated much success at assuring grid reliability in the Western United States.

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[87] See, e.g., California Commission, City of Seattle, CREPC and New York ISO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

279. Many commenters support the need for a high level of uniformity of Reliability Standards for Regional Entities within one Interconnection. International Transmission, for example, states that there should be fewer regional differences for regions within the same Interconnection.

280. Favoring the opportunity for regional differences, NPCC and NYSRC recommend that the Commission not force on the regions a "one-size-fits-all" approach that ignores unique regional needs and concerns.[88] Such an approach, they argue, would eventually degrade reliability in eastern Canada and the northeastern portion of the United States. NYSRC notes that EPAct does not require conformity but, rather, anticipates that a Regional Entity may propose a regional Reliability Standard applicable within its region. PSNM-TNPC is concerned that a focus on uniformity of Reliability Standards would result in an abrupt transition for market participants, which would have a negative impact on grid investment and introduce significant uncertainty into transmission planning efforts.

281. ISO New England comments that regional differences in the Bulk-Power System exist for historical reasons; and because there are such differences, uniform continent-wide Reliability Standards may not be appropriate in all instances.

282. Several commenters, such as the California ISO, support a regional variance that for a regional Reliability Standard that is more stringent than the one developed by the

[88] See also ISO/RTO Council, NARUC, New York ISO and PSNM-TNPC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

ERO. FirstEnergy favors regional differences, while also supporting a single set of Reliability Standards proposed by the ERO and approved by the Commission. It believes in standardization to the greatest extent possible, but would make an exception if a proposed regional difference is found by the ERO: (1) to be reasonable and not unduly discriminatory; (2) to be more stringent than an ERO Reliability Standard; and (3) would result in no harm to reliability in any other region. Similarly, the ISO/RTO Council asserts that a regional difference, especially a more stringent regional requirement, should be allowed where clearly justified to support specific, identifiable regional needs.

283. Dominion asserts that there should be no requirement for a transmission owner to change to a Regional Entity's Reliability Standards, principles, or guidelines, or to move to a new set of Reliability Standards, in order to conform to all current Reliability Standards of other NERC regions within an RTO. Such a requirement would be very expensive and would require rebuilding the transmission system without providing appreciable improvements in the reliability of the system. Dominion recommends that the Commission permit a grandfathering arrangement so that changes from one Regional Entity to another do not have the effect of causing a transmission owner to rebuild the existing transmission system. Dominion urges the Commission to maintain this flexibility since it is not detrimental to reliability.

284. Further, Dominion asserts that where a transmission owner's system extends across more than one Regional Entity, the Commission should not prescribe the Regional Entity's Reliability Standards with which the transmission owner must comply. It argues that such transmission owners have made their transmission facilities conform to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

different Reliability Standards, either geographically or over time, as set by existing regional reliability councils. Changing design and maintenance standards now to meet the Reliability Standards of a single Regional Entity would be difficult and costly.

285. NERC, SERC and Cinergy suggest that regional criteria represent a middle layer between enforceable Reliability Standards and the operating and planning protocols of each entity. These, they argue, should not require Commission approval and would not be enforceable under section 215 of the FPA. Cinergy asserts that any operating Rule that is to be enforceable should be considered a de facto Reliability Standard, submitted back to the ERO for review, and submitted to the Commission for approval.

286. NERC notes several conditions that could result in regional differences: (1) a proposed ERO Reliability Standard may conflict with a regional practice, such as a Commission-approved protocol in an RTO tariff; (2) an ERO Reliability Standard may require a Regional Entity to define regional criteria and procedures necessary to implement the Reliability Standard; and (3) a region may already have a more stringent requirement than the continent-wide Reliability Standard to meet the needs of the electric system within a particular area.

287. Michigan Electric states that the Commission should articulate clear policies with respect to the various types of regional differences, including which differences are permitted, how such differences would be developed, and the process that should be used by the ERO to review a regional difference proposed by a Regional Entity.

288. Many commenters, such as AEP, Ameren, AWEA, ELCON, EPSA, Exelon, FRCC, and International Transmission, as well as NERC, support the Commission's

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

proposal that any enforceable regional difference be incorporated into the set of ERO Reliability Standards.

289. Other commenters, however, disagree with the Commission's proposal that any regional difference be part of the ERO Reliability Standards. The California Board and SoCalEd argue that the Commission's interpretation of section 215(d)(3) is incorrect. While the California Board agrees that EPAct creates a process for the proposal and approval of a regional Reliability Standard, it sees nothing in EPAct to suggest than an Interconnection-wide Reliability Standard may not be considered a Regional Entity Reliability Standard.

Commission Conclusion

290. The Commission believes that uniformity of Reliability Standards should be the goal and the practice, the rule rather than the exception. Greater uniformity will encourage best practices, thereby enhancing reliability and benefiting consumers and the economy. Congress envisioned greater uniformity in adopting section 215 and a broad cross-section of the industry supports this goal. At our November 18, 2005 technical conference, Michael Morris, the Chairman and CEO of American Electric Power, Inc., testifying on behalf of EEI, stated that: "The regional differences should be few . . . and the enforcement latitude should be small." Tr. at 77:25-78:1 (Nov. 18, 2005). His fellow panelists, representing various sectors of the industry, agreed with his remarks.

291. The goal of greater uniformity does not, however, mean that regional differences cannot exist. We agree with WECC, NPCC, and others that section 215 of the FPA provides for exceptions from continent-wide uniformity in a Reliability Standard.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Accordingly, we provide guidance on the criteria for considering such exceptions. As a general matter, we will accept the following two types of regional differences, provided they are otherwise just, reasonable, not unduly discriminatory or preferential and in the public interest, as required under the statute: (1) a regional difference that is more stringent than the continent-wide Reliability Standard, including a regional difference that addresses matters that the continent-wide Reliability Standard does not; and (2) a regional Reliability Standard that is necessitated by a physical difference in the Bulk-Power System.

292. We also recognize that greater uniformity cannot be achieved overnight. For example, a significant number of current regional standards have been developed on topics for which there is no continent-wide standard, but rather only a NERC directive that the regions develop a particular standard. Over time, we would expect that the regional differences produced under this framework will decline and a set of best practices will develop. We would expect that any ERO applicant will propose a process by which regional differences in this and other areas can be refined into a set of best practices over time. This is particularly important for the Reliability Standards that apply to regions within an Interconnection. Although we encourage the development of continent-wide best practices, we recognize that greater diversity may be appropriate as between the Interconnections than within them.

293. In response to PSNM-TNPC's concern that an abrupt transition to uniform Reliability Standards would negatively affect grid investment and transmission planning efforts, PSNM-TNPC has presented no convincing argument that this effect would occur.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

We expect that more uniformity of requirements could foster new investment. We agree, however, that those proposing uniform Reliability Standards should take into account the cost and time needed to achieve uniformity.

294. The Commission does not establish here a generic grandfathering arrangement that would exempt any user, owner or operator from having to comply with any change in a Reliability Standard or a change resulting from a move to another Regional Entity. A user, owner or operator must follow the Reliability Standards of the ERO and the Regional Entity within which it is located. The expected level of uniformity of continent-wide Reliability Standards and of Reliability Standards within an Interconnection should protect any owner or operator that moves from one Regional Entity to another from incurring a large cost.

295. Until a proposed regional difference is filed by the ERO with the Commission and approved by the Commission, any ERO-developed and Commission-approved continent-wide Reliability Standard is in effect and enforceable. No regional difference is enforceable under section 215 of the FPA until it is filed by the ERO with the Commission and approved by the Commission.

296. Any regional difference shall be considered part of the ERO's set of Reliability Standards. A regional difference that is proposed to the Commission by the ERO and approved by the Commission is an ERO Reliability Standard, not a Regional Entity Reliability Standard in the sense that California Board suggests.

297. In response to the Western Governments and the California Commission, while the Commission cannot simply defer to the members of the Western Interconnection in

regard to the establishment of regional Reliability Standards for the West, we recognize that there may be justifiable differences in a Reliability Standard based on physical differences in the electrical systems. In addition, we respect the rebuttable presumption afforded by section 215 of the FPA to a proposal for a Reliability Standard from a Regional Entity organized on an Interconnection-wide basis, as discussed below.

iv. Rebuttable Presumption for a Reliability Standard Proposed by an Interconnection-wide Regional Entity

298. The proposed rule would require the ERO to rebuttably presume that a proposed Reliability Standard or a modification to a Reliability Standard to be applicable on an Interconnection-wide basis is just, reasonable, not unduly discriminatory or preferential, and in the public interest if it is proposed by a Regional Entity organized on an Interconnection-wide basis.

Comments

299. The ISO/RTO Council remarks that the rebuttable presumption is only an evidentiary presumption, not a requirement to accept any proposal. While complying with basic due process requirements, the ERO has a duty to collect information on the advantages and disadvantages of any proposed Reliability Standard. It states, however, that if after completing its due diligence, the ERO has not found any information rebutting the presumption, the ERO would accept the proposal.

300. WECC and WestConnect ask the Commission to clarify the scope of the ERO's authority in reviewing a Reliability Standard proposed by an Interconnection-wide Regional Entity. Both recommend that the ERO be required to give substantial weight to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the statutory presumption and deem it rebutted only in the most unusual circumstances based upon clear, convincing, and documented evidence. To accomplish this, WECC proposes a modification to the proposed regulation stating that, absent a showing based upon clear and convincing evidence rebutting the presumption, the ERO must promptly forward to the Commission a proposed Reliability Standard entitled to a rebuttable presumption. Further, the Regional Entity entitled to the rebuttable presumption should have an opportunity to respond to any evidence allegedly rebutting the presumption as well as an opportunity to appeal a decision not to forward a proposed Reliability Standard entitled to a rebuttable presumption to the Commission.

Commission Conclusion

301. We clarify that the rebuttable presumption in section 39.5(b) refers to the burden of proof before the ERO. Any person objecting to the proposed Reliability Standard before the ERO would have the burden of demonstrating to the ERO that a Reliability Standard proposed by an Interconnection-wide Regional Entity does not satisfy the ERO criteria for approval and is therefore not entitled to any presumption. The opportunity for the Regional Entity to respond to a rebuttal should be set out in the ERO Rules, as discussed above under due process. If the ERO does not find that the presumption is adequately rebutted, it must accept the proposed Reliability Standard from a Regional Entity organized on an Interconnection-wide basis to be just, reasonable, not unduly discriminatory or preferential, and in the public interest and must submit such a proposed Reliability Standard to the Commission for approval.

b. Reliability Standard Approval by the Commission

i. Commission Review

(a) Commission Review Process

302. The proposed regulations on Reliability Standards provided that the Commission may approve a proposed Reliability Standard by rule or order. The NOPR states that the Commission anticipates that it will provide notice and opportunity for hearing of any proposed Reliability Standard or modification to a Reliability Standard.

Comments

303. The few comments on this section generally recommend certain refinements to the process outlined in the NOPR. LADWP, however, suggests that greater detail and precision is required in the Final Rule.

304. NERC generally supports the open process for considering a proposed Reliability Standard described in the NOPR, including the Commission's plan to provide interested parties opportunity to comment on a proposed Reliability Standard. NERC believes that, because of the technical nature of a Reliability Standard, a paper hearing would provide adequate opportunity for interested parties to explain their position. Southern recommends that the Commission clarify that a proceeding regarding a proposed Reliability Standard would generally be a paper hearing, not a trial-type adjudication.

305. LADWP asserts that the Commission's statement in the NOPR that it "generally anticipates" that it will provide notice and opportunity for hearing of any proposed

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard is antithetical to the concept of due process in the FPA and the Administrative Procedure Act (APA).[89] NiSource also emphasizes the need for notice and public comment.

306. FirstEnergy recommends that the Commission adopt an expedited review process for any proposed Reliability Standard developed through an ANSI-accredited process. A Commission hearing is unnecessary for a Reliability Standard that was already subject to an open stakeholder process. Ontario IESO and Progress Energy add that any perception that the Commission's review process allows new debate on a proposed Reliability Standard would weaken participants' commitment to the ERO's process.

Commission Conclusion

307. In response to the comments of NERC and Southern, although the Commission agrees that it is likely that most proposed Reliability Standards would be decided on a paper hearing, we will not eliminate the possibility of setting a proposed Reliability Standard for a trial-type hearing before an Administrative Law Judge, if appropriate.

308. With regard to the comments of NiSource and LADWP, we note that section 215(c)(2)(D) of the FPA specifically requires the ERO to provide for reasonable notice and opportunity for public comment in developing a Reliability Standard. In contrast, section 215 does not specifically require that the Commission provide notice and an opportunity for public comment when reviewing a Reliability Standard proposed by the

[89] 5 U.S.C. Subchapter II (2005).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

ERO. We will, however, provide notice and opportunity for public comment except in extraordinary circumstances. We note that section 215 of the FPA provides for an ERO Reliability Standard development process open to the participation of affected entities and do not want to encourage these entities to bypass that process in anticipation of raising concerns only with the Commission. Except in extraordinary circumstances, we expect persons commenting to the Commission about a proposed Reliability Standard to explain how they presented their views of the proposed Reliability Standard in the ERO or Regional Entity process and the result.

309. FirstEnergy asks the Commission to develop an expedited review process for all proposed Reliability Standards. While it may be appropriate to expedite the process for a particular proposed Reliability Standard, we will not establish a special expedited process at the Commission for all proposed Reliability Standards in the Final Rule. The Commission may choose to have, or the ERO or others may petition for, an expedited review of a particular proposed Reliability Standard which may include waiver of our normal procedure for notice and an opportunity for comment.

(b) Legal Standard of Review of a Proposed Reliability Standard

310. The Commission asked for comments on how the legal standard of review, i.e., whether a proposed Reliability Standard is "just, reasonable, not unduly discriminatory or

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

preferential, and in the public interest," should be applied to review of a proposed Reliability Standard.[90]

Comments

311. Comments vary on how the Commission should apply the standard of review. Some commenters offer a general principle while others suggest multi-part tests. Some commenters recommend that the Commission presume that a proposed Reliability Standard vetted through an ANSI-certified process meets the standard of review.

312. EEI states that the Commission should remain flexible in applying the statutory standard of review to a proposed Reliability Standard. According to EEI, a Reliability Standard should be based on technical and operational factors, and not vary with facility ownership. SMA and Oklahoma Commission suggest that the ERO should have the burden of demonstrating that a proposed Reliability Standard satisfies the statute's legal standard.

313. Some commenters offer an overarching principle. For example, Southern and SERC suggest that, to satisfy the legal standard of review, a proposed Reliability Standard should promote the reliability of the Bulk-Power System. NYSRC remarks that the Commission should apply a general rule, such as, "reasonably necessary to maintain an adequate level of reliability of the bulk power system."

[90] NOPR at P 55.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

314. Other commenters offer separate analysis for the three elements of the standard of review "just and reasonable," "undue discrimination" and "public interest." For example, APPA recommends that the Commission consider whether a proposed Reliability Standard is fair, whether it unjustifiably discriminates in its application among users of the Bulk-Power System and whether it furthers the public good. FRCC states that the proposed Reliability Standard must also not tilt the playing field in favor of a particular competitor or group of competitors. Alcoa and ERCOT suggest that the Commission should weigh the reliability benefits provided by a Reliability Standard with the overall cost or impact of compliance.

315. FRCC recommends that, for the Commission to find a proposed Reliability Standard to be just and reasonable, the ERO must demonstrate that its proposal is reasonably necessary to achieve a legitimate reliability objective and not unduly expensive or burdensome relative to the benefits of the objective. FRCC suggests that the ERO should have to include with its submission an analysis of the costs, risks and benefits of each proposed Reliability Standard to add economic rigor to the Reliability Standard development process. For the Commission to find a proposed Reliability Standard to be not unduly discriminatory, no entity or group of entities should be required to bear costs that are disproportionate to the efficient costs of achieving reliability. EEI states that if the Commission finds that a proposed Reliability Standard may have an unduly discriminatory impact that is unrelated to technical or operational requirements, it should remand the proposed Reliability Standard to the ERO to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

determine whether the same level of reliability can be achieved in a non-discriminatory way.

316. NRECA proposes that the Commission determine whether (1) a proposed Reliability Standard would accomplish its intended effect in an efficient and effective manner (just and reasonable); (2) entities that are similarly situated receive similar or comparable treatment, and appropriate differences are recognized for entities that are not similarly situated (not unduly discriminatory); and (3) the reliability benefits are achieved in a manner that does not undermine, but may further, other legitimate objectives (public interest). Further, the Commission should ensure that a proposed Reliability Standard does not unnecessarily burden small utilities that minimally impact reliability.

317. Alcoa comments that a proposed Reliability Standard should meet the following additional criteria: (1) the proposal is grounded in sound transmission engineering principles; (2) its requirements are clearly and unambiguously stated; and (3) it is not unduly burdensome or beneficial with respect to any particular class of operators, stakeholders, or end users.

318. The ISO/RTO Council identifies numerous factors for the Commission to consider, including: (1) Is the particular proposed Reliability Standard the best way to define and measure the intended reliability objective and has the ERO evaluated the consequential impacts of the Reliability Standard? (2) Have any conflicts between the proposed Reliability Standard and approved tariffs been resolved? (3) Will entities be able to implement the proposed Reliability Standard in a relatively uniform manner? and

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

(4) Is the proposed Reliability Standard capable of being implemented and enforced in other affected countries as well as the United States?

319. Numerous commenters ask that the Commission defer to the technical expertise of the industry if a proposed Reliability Standard is developed through an ANSI-certified (or other open and fair) stakeholder process.[91] They explain that an ANSI-certified process will have important attributes, including due process, openness, and balance, and will result in the most technically sound Reliability Standards. Some of these commenters[92] recommend that the Commission establish a rebuttable presumption that a Reliability Standard developed through an ANSI-accredited process satisfies the legal standard.

Commission Conclusion

320. We find informative the recommendations of commenters on criteria for reviewing a proposed Reliability Standard, particularly on how to apply the legal standard of review, "just, reasonable, not unduly discriminatory or preferential, and in the public interest." Although we will not adopt every test that commenters propose, we do provide here general guidance regarding how the Commission will review a proposed Reliability Standard.

321. The proposed Reliability Standard must address a reliability concern that falls within the requirements of section 215 of the FPA. That is, it must provide for the

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[91] See, e.g., AEP, NARUC, NERC, Northeast Utilities, Progress Energy, PSEG Companies, Santee Cooper, SoCalEd, TVA and Ontario IESO.

[92] See, e.g., NERC, Santee Cooper and SoCalEd.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

reliable operation of Bulk-Power System facilities. It may not extend beyond reliable operation of such facilities or apply to other facilities. Such facilities include all those necessary for operating an interconnected electric energy transmission network, or any portion of that network, including control systems. The proposed Reliability Standard may apply to any design of planned additions or modifications of such facilities that is necessary to provide for reliable operation. It may also apply to Cybersecurity protection.

322. The proposed Reliability Standard may impose a requirement on any user, owner, or operator of such facilities, but not on others.

323. In considering whether a proposed Reliability Standard is just and reasonable, we will consider the following general factors, as well as other factors that are appropriate for the particular Reliability Standard proposed.

324. The proposed Reliability Standard must be designed to achieve a specified reliability goal and must contain a technically sound means to achieve this goal. Although any person may propose a topic for a Reliability Standard to the ERO, in the ERO's process, the specific proposed Reliability Standard should be developed initially by persons within the electric power industry and community with a high level of technical expertise and be based on sound technical and engineering criteria. It should be based on actual data and lessons learned from past operating incidents, where appropriate. The process for ERO approval of a proposed Reliability Standard should be fair and open to all interested persons.

325. The proposed Reliability Standard should be clear and unambiguous regarding

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

what is required and who is required to comply. Users, owners, and operators of the Bulk-Power System must know what they are required to do to maintain reliability.

326. The possible consequences, including range of possible penalties, for violating a proposed Reliability Standard should be clear and understandable by those who must comply.

327. There should be a clear criterion or measure of whether an entity is in compliance with a proposed Reliability Standard. It should contain or be accompanied by an objective measure of compliance so that it can be enforced and so that enforcement can be applied in a consistent and non-preferential manner.

328. The proposed Reliability Standard does not necessarily have to reflect the optimal method, or "best practice," for achieving its reliability goal without regard to implementation cost or historical regional infrastructure design. It should however achieve its reliability goal effectively and efficiently.

329. The proposed Reliability Standard must not simply reflect a compromise in the ERO's Reliability Standard development process based on the least effective North American practice—the so-called "lowest common denominator"—if such practice does not adequately protect Bulk-Power System reliability. Although the Commission will give due weight to the technical expertise of the ERO, we will not hesitate to remand a proposed Reliability Standard if we are convinced it is not adequate to protect reliability.

330. A proposed Reliability Standard may take into account the size of the entity that must comply with the Reliability Standard and the cost to those entities of implementing the proposed Reliability Standard. However, the ERO should not propose a "lowest

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

common denominator" Reliability Standard that would achieve less than excellence in operating system reliability solely to protect against reasonable expenses for supporting this vital national infrastructure. For example, a small owner or operator of the Bulk Power-System must bear the cost of complying with each Reliability Standard that applies to it.

331. A proposed Reliability Standard should be designed to apply throughout the interconnected North American Bulk-Power System, to the maximum extent this is achievable with a single Reliability Standard. The proposed Reliability Standard should not be based on a single geographic or regional model but should take into account geographic variations in grid characteristics, terrain, weather, and other such factors; it should also take into account regional variations in the organizational and corporate structures of transmission owners and operators, variations in generation fuel type and ownership patterns, and regional variations in market design if these affect the proposed Reliability Standard.

332. As directed by section 215 of the FPA, the Commission itself will give special attention to the effect of a proposed Reliability Standard on competition. The ERO should attempt to develop a proposed Reliability Standard that has no undue negative effect on competition. Among other possible considerations, a proposed Reliability Standard should not unreasonably restrict available transmission capability on the Bulk-Power System beyond any restriction necessary for reliability and should not limit use of the Bulk-Power System in an unduly preferential manner. It should not create an undue advantage for one competitor over another.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

333. In considering whether a proposed Reliability Standard is just and reasonable, the Commission will consider also the timetable for implementation of the new requirements, including how the proposal balances any urgency in the need to implement it against the reasonableness of the time allowed for those who must comply to develop the necessary procedures, software, facilities, staffing or other relevant capability.

334. Further, in considering whether a proposed Reliability Standard meets the legal standard of review, we will entertain comments about whether the ERO implemented its Commission-approved Reliability Standard development process for the development of the particular proposed Reliability Standard in a proper manner, especially whether the process was open and fair. However, we caution that we will not be sympathetic to arguments by interested parties that choose, for whatever reason, not to participate in the ERO's Reliability Standard development process if it is conducted in good faith in accordance with the procedures approved by the Commission.

335. Finally, we understand that at times development of a proposed Reliability Standard may require that a particular reliability goal must be balanced against other vital public interests, such as environmental, social and other goals. We expect the ERO to explain any such balancing in its application for approval of a proposed Reliability Standard.

336. In addition to the factors above, in considering a Reliability Standard originally developed by a Regional Entity for application only within its own region, the Commission will consider other appropriate factors in determining if the proposed Reliability Standard is just and reasonable, not unduly discriminatory or preferential, and

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

in the public interest. These include, but are not necessarily limited to, whether a regional difference is necessary or appropriate to maintain reliability and whether such a regional difference would affect reliable operation in another region. The ERO should also examine such factors in its consideration of such a regional proposal.

337. In applying the legal standard to review of a proposed Reliability Standard, the Commission will consider the general factors above. The ERO should explain in its application for approval of a proposed Reliability Standard how well the proposal meets these factors and explain how the Reliability Standard balances conflicting factors, if any. The Commission may consider any other factors it deems appropriate for determining if the proposed Reliability Standard is just and reasonable, not unduly discriminatory or preferential, and in the public interest. The ERO applicant may, if it chooses, propose other such general factors in its ERO application and may propose additional specific factors for consideration with a particular proposed Reliability Standard.

338. We reject the notion that we should presume that a proposed Reliability Standard developed through an ANSI-certified process automatically satisfies the statutory standard of review. In this regard, we agree with EEI and others that the development of a Reliability Standard through the ERO's stakeholder process is no guarantee that a proposed Reliability Standard does not have a discriminatory impact or negative effect on competition even if the proposal meets its technical or operational objective.

ii. Due Weight to Technical Expertise of the ERO and a Regional Entity Organized on an Interconnection-wide Basis

339. Consistent with the statute, the NOPR proposed that the Commission shall give due weight to the technical expertise of the ERO or a Regional Entity organized on an Interconnection-wide basis.

Comments

340. NERC comments that the Commission is correct in recognizing that due weight should be given to the technical content of a Reliability Standard proposed by the ERO or a Regional Entity organized on an Interconnection-wide basis. However, the ISO/RTO Council and others question what it means to give such "due weight." PacifiCorp and APPA suggest that providing "due weight" means that the Commission will rebuttably presume that a Reliability Standard proposed by an Interconnection-wide Regional Entity is just, reasonable, not unduly discriminatory or preferential, and in the public interest. PacifiCorp asks the Commission to clarify that it will approve such a proposed Reliability Standard in the absence of a specific finding that it would detrimentally affect competition to a substantial degree. APPA believes that the requirement that the ERO rebuttably presume the justness and reasonableness of an Interconnection-wide Regional Entity's proposal implies that the Commission must give the same rebuttable presumption.

341. The ISO/RTO Council, in contrast, comments that EPAct does not direct the Commission to afford either the ERO or any Regional Entity the benefit of any presumption that a proposed Reliability Standard is just and reasonable. It is concerned

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

that the ERO not become an automatic pass-through mechanism for all Reliability Standards proposed by any Regional Entity organized on an Interconnection-wide basis.

342. The Oklahoma Commission asks that the Commission not interpret the statutory grant of deference as a shift in the burden of proof; instead, the entity with the expertise should provide support for its proposal. Similarly, SMA suggests that the entity submitting a proposed Reliability Standard should have the burden of proof, just as the filing party has the burden of proof in an FPA section 205 or section 206 proceeding.

343. NiSource requests clarification of the extent to which the Commission will give due weight to the technical expertise of a Regional Entity organized on an Interconnection-wide basis. Section 38.4(b)(1) of the proposed regulation makes clear that the Commission will give deference to the ERO for both a new and a modified proposed Reliability Standard. For a Regional Entity, however, proposed section 38.4(b)(2) refers to deference "with respect to a Reliability Standard." NiSource assumes the Commission intends to apply that deference to both a new and a modified proposed Reliability Standard, but requests clarification on that point.

Commission Conclusion

344. The Commission adopts the provisions on due weight as proposed in the NOPR. The Commission will give due weight to the ERO and a Regional Entity organized on an Interconnection-wide basis with respect to their technical expertise.

345. We do not agree that giving due weight means a rebuttable presumption that the Reliability Standard meets the statutory requirement of being just, reasonable, not unduly discriminatory or preferential, and in the public interest. Rather, we agree with the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Oklahoma Commission and SMA that the ERO must justify to the Commission its contention that the proposed Reliability Standard or proposed modification to a Reliability Standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest.

346. Regarding the request for clarification by NiSource, we confirm that we will give due weight to the technical expertise of a Regional Entity organized on an Interconnection-wide basis with respect to either a proposed Reliability Standard modification or a new proposed Reliability Standard. The Final Rule reflects this in section 39.5(c)(2).

iii. Due Weight to the Technical Expertise of a Regional Entity Not Organized on an Interconnection-wide Basis

347. The Commission interpreted sections 215(d)(2) and (3) of the FPA as not requiring the Commission to accord any additional weight to the technical expertise of a Regional Entity not organized on an Interconnection-wide basis and not creating a rebuttable presumption with regard to the reasonableness of a Reliability Standard proposed by the ERO or proposed to it by such a Regional Entity for ERO consideration.[93]

[93] NOPR at P 46.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Comments

348. Many commenters suggest that the Commission should also give due weight to the technical expertise of a Regional Entity not organized on an Interconnection-wide basis.[94] They note that, while the Commission is not required to give such due weight, nothing in section 215 precludes the Commission from doing so in appropriate circumstances. MidAmerican suggests that the Commission give appropriate deference to the technical expertise of a Regional Entity that represents a significant portion of the Eastern Interconnection without being an Interconnection-wide organization. In a similar vein, Northeast Utilities asserts that the extension of deference by Congress to an Interconnection-wide Regional Entity should not be read as a directive that a Regional Entity that is smaller in scope is entitled to no deference at all. Rather, the Commission should recognize that certain organizations that are not Interconnection-wide have a long history of developing more stringent standards for regions that seek more reliable service or have unique local circumstances.

349. According to the New York Companies, the Commission's interpretation that only an Interconnection-wide Regional Entity is statutorily entitled to due weight would result in two classes of Regional Entities and would disadvantage Regional Entities that are in a large, complex Interconnection where regional technical expertise is valuable. NYSRC

[94] See, e.g., Ameren, California ISO, Dairyland, MidAmerican, MISO Owners, NE Pool Participants, New York Companies, NiSource, NYSRC, New York ISO and TANC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

and Dairyland contend that the Commission should provide due deference to all Regional Entities since they must satisfy the certification criteria applicable to the ERO.

350. FRCC and Southern comment that a Reliability Standard proposed by a Regional Entity not organized on an Interconnection-wide basis must be approved by the ERO. Further, EPAct requires the Commission to give due weight to the ERO's determinations. Therefore, when reviewing such a proposed Reliability Standard, the Commission must give due weight to the underlying technical determinations made by the ERO because the proposal will have undergone ERO review and approval.

Commission Conclusion

351. The statute provides that in the case of a Reliability Standard proposed by a Regional Entity organized on an Interconnection-wide basis the Commission should give due weight to the technical expertise of that Regional Entity. The statute does not provide for similar treatment for a Regional Entity that is not organized on an Interconnection-wide basis. However, as a practical matter, the Commission will give appropriate weight to the expertise of any Regional Entity, and in all cases a proposed Reliability Standard must be supported by the record. As stated above, the statute also provides for a "rebuttable presumption" by the ERO that a proposed Reliability Standard from an Interconnection-wide Regional Entity is just and reasonable but does not provide for similar treatment for a Regional Entity that is not organized on an Interconnection-wide basis. Accordingly, no such presumption shall apply for Regional Entities that are not organized on an Interconnection-wide basis.

iv. No deference on Competition

352. Consistent with the statute, the proposed regulations provided that the Commission shall not defer to the ERO or a Regional Entity with respect to the effect of a proposed Reliability Standard on competition. The NOPR asked how the Commission should define competition in this context and asked for examples of the effects of a Reliability Standard on competition.[95]

Comments

353. Commenters explain that reliability and competition are intrinsically linked. They provide several examples of the possible effects of a Reliability Standard on competition. Commenters provide varying definitions of competition. Substantive comments on this section are grouped into three categories: (a) linkage between reliability and competition; (b) definition of competition; and (c) Commission weighing of competitive effects.

(a) Linkage between Reliability and Competition

354. Many commenters emphasize the close link between reliability and competition.[96] EEI and Entergy remark that it is difficult to define a Reliability Standard that has no impact on competition. The ISO/RTO Council explains that a Reliability Standard can adversely impact competition either by creating a preference for one market participant over another (by defining the limits within which market participants compete) or by

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[95] NOPR at P 48.

[96] See, e.g., AEP, Ameren, Exelon, National Grid, NERC, Santee Cooper and SPP.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

driving an outcome that eliminates the ability of the market to respond to reliability needs with market-oriented solutions.

355. NERC notes that it currently uses five market-reliability interface principles in developing a Reliability Standard: (1) the planning and operation of bulk electric systems shall recognize that reliability is an essential requirement of a robust economy; (2) a Reliability Standard shall not give any market participant an unfair competitive advantage; (3) a Reliability Standard shall neither mandate nor prohibit any specific market structure; (4) a Reliability Standard shall not preclude market solutions to achieving compliance with that Reliability Standard; and (5) a Reliability Standard shall not require the public disclosure of commercially sensitive information.

356. Commenters identify numerous examples of the effects a Reliability Standard may have on competition. EEI, SPP and others the identify transmission loading relief curtailment practice as an example of a Reliability Standard that affects competition. SPP states that there are a number of market-based solutions to relieving congestion but each has different results in reliability and market outcomes. EEI also identifies as examples line rating methodologies, generator testing requirements and calculation of available transfer capability.

357. TAPS identifies the treatment of inadvertent exchange and energy imbalance as a Reliability Standard that has an effect on competition. Inadvertent interchange between control areas may be returned in kind, while non-control area utilities are subject to unduly burdensome penalties for energy imbalances outside a narrowly defined range.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

358. CenterPoint comments that the link between reliability and competition is exemplified by a Reliability Standard mandating the provision of reactive power by generating units connected to the grid. While necessary for reliable operation of the grid, generators could argue that such a Reliability Standard is anticompetitive because it may not allow them to supply as many megawatts to the grid as they would be able to supply absent the Reliability Standard or would otherwise reduce the generators' operating margins.

359. SoCalEd identifies reliability-must-run (RMR) generation and local area reliability service (LARS) as examples of Reliability Standards that can affect competition. SoCalEd states that the designation of generators as RMR and LARS generation can result in market power for these resources, to the detriment of the wholesale market and customers.

(b) <u>Definitions of Competition</u>

360. While commenters suggest varying definitions of "competition," many focus on multiple sellers serving a market. For example, EPSA states that, fundamentally, competition means the rivalry among multiple businesses to supply potential customers with a particular product or service within a given market. Generally, a Reliability Standard that would influence anyone's opportunity to compete, or to benefit from such competition, can be said to affect competition, although the significance of the impact will vary. EPSA states that the Commission should also consider whether a proposed Reliability Standard would increase operating costs, reduce available transmission

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

capacity, deter flexible operations, ensure timely access to information, or deter new entry.

361. SPP and AEP would define "competition" as a business environment in which more than one supplier can potentially serve a market with like products and services and the customer has the ability to choose the supplier that best serves its needs. APPA describes competition as the "availability or price of transmission service or bulk power supplies to a user or class of users of the bulk power system."

362. NARUC suggests defining "competition" for the evaluation of a proposed Reliability Standard as "commercial activities within the electric industry that are limited in some way by the physical limitations of the bulk power system."

363. Exelon quotes an American Heritage Dictionary definition of competition but also adds the following electricity-market-specific characteristics: (1) many suppliers accessing the transmission system to market diverse products to customers; (2) available information about access and cost that allows market participants to identify and allocate commercial risks; (3) efficient physical market structures and operations that provide a strong platform for the development of financial markets; (4) minimized market entry and exit costs; (5) all interested parties are permitted to invest in and create new infrastructure; and (6) a marketplace free from undue discriminatory treatment.

364. American Transmission and others focus on whether the impact of a Reliability Standard on market participants would result in undue discrimination. ELCON states the effect of a Reliability Standard on competition lies in the ability of a market participant to use the Reliability Standard to influence the price of a transaction or discriminate against

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

a competitor, or to give preferential treatment to one class of market participants. Entergy recommends that the Commission focus its reviews on ensuring that the proposed Reliability Standard does not have an unduly discriminatory impact on a particular class of customers.

365. The New York Companies suggest that competition be defined as the existence of "effective" competition. For example, if a specific Reliability Standard requires the provision of a service that only a few entities can provide, the Reliability Standard should consider whether there are any barriers to the provision of that service in a competitive manner. If so, the Commission must determine if this service should be provided on a cost-of-service basis rather than on a competitive basis.

366. AWEA recommends that the Commission apply the classical criteria of "perfect" competition. Thus, any Reliability Standard that reduces the number of buyers or sellers, creates barriers to entry or exit, reduces the information available to the market, or increases transaction costs should be deemed to harm competition. Such harm to competition must be weighed against the reliability benefits—except for discrimination which must not be balanced against other factors.

367. Other commenters, such as Ameren, FRCC and MidAmerican, state that the Commission should evaluate the effect of a proposed Reliability Standard on competition on a case-by-case basis. Ameren suggests that the Commission decide for each proposed Reliability Standard whether it would effect competition in an unreasonable way.

368. TAPS notes that competition takes place not only through prices, but also through the quality of service. The Commission must consider the competitive impact of a

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard in the context of retail and wholesale markets, as well as in the context of other jurisdictional tariffs, rate schedules, rules and policies, and business practices.

369. Kansas City P&L states that Reliability Standards should be based on the physical limitations and operational parameters of the Bulk-Power System for reliable, stable operation. Rules, regulations and policy that determine the market actions necessary to conduct business, including promoting competition, should follow the framework and structures created by the Reliability Standards, not vice-versa.

(c) Commission Weighing of Competitive Effects

370. Commenters offer various prescriptions regarding how the Commission should weigh competitive effects when reviewing a proposed Reliability Standard. Ohio Commission and others emphasize that system reliability is paramount and should not be compromised. International Transmission comments that Reliability Standards are not a barrier to competition but, rather, support competition since reliability is the basis on which competitive markets are built. Thus, incidental effects on competition cannot be allowed to overrule the need for strong Reliability Standards.

371. National Grid comments that the Commission's assessment of the competitive effects of a proposed Reliability Standard should involve a traditional balancing of various factors, and the Commission should approve a proposed Reliability Standard that meets a reliability need as long as it would not unduly harm competition.

372. Old Dominion comments that the Commission should prefer Reliability Standards that promote competition, while rejecting or correcting Reliability Standards that harm

competition. NRECA comments that, rather than reject a proposed Reliability Standard out of concern for the effect it may have on competition, it is more appropriate for the Commission to change market rules under FPA section 206. It is easier for entities to adapt to a new Reliability Standard than it is for the Commission to compensate consumers for the enormous economic disruption caused by a widespread outage on the Bulk-Power System.

373. MISO comments that the Commission should ensure that Reliability Standards are compatible with competitive energy markets. However, SERC and TVA are concerned that reliability not be made secondary to the promotion of competitive markets. SoCalEd and National Grid similarly note that effects on competition in non-formal, bilateral markets must be considered, and any evaluation of effects on competition should not be limited to an assessment of organized electricity markets under RTOs or ISOs.

374. CenterPoint asserts that it is appropriate and in the public interest for Reliability Standards to affect competition in certain instances. It states that the Commission and the ERO cannot unreasonably discriminate among competitors, but it is reasonable and in the public interest, and consistent with the intent of EPAct, to establish Reliability Standards that afford an advantage to competitors that enhance the reliability of the grid over competitors that do not.

375. NARUC and others note that NERC's existing standards development process works to minimize the impact of Reliability Standards on competition by working closely with NAESB, which establishes business practice standards. Others, such as MidAmerican and PSEG Companies, recommend that the Commission use the processes

developed jointly by NERC and NAESB as an appropriate indication of the demarcation between the reliability and commercial aspects of the Bulk-Power System.

Commission Conclusion

376. While it is clear that reliability and competition may be intrinsically linked at times, the Commission declines to adopt a generic test to balance reliability and competition concerns in the absence of specific facts. We will evaluate the effects of a proposed Reliability Standard on competition on a case-by-case basis.

377. Although comments on how to define competition have been informative, we conclude that no such definition is necessary in the Final Rule. No single definition appears sufficient to cover all the relevant bases for evaluating a proposed Reliability Standard's effect on competition.

378. In approving a Reliability Standard, we will ensure that it does not have the implicit effect of either favoring or thwarting either bilateral or organized markets. At the same time, we will also ensure that a proposed Reliability Standard does not unduly favor either individual participants or certain classes of participants, as required by the statute. Accordingly, we will balance any conflict between a proposed Reliability Standard and competition on a case-by-case basis.

c. Effective Date

379. The proposed regulations provided that an approved Reliability Standard or a modification to a Reliability Standard shall take effect "as approved by the Commission."

380. MidAmerican asks that the Commission revise the provision to state that a Reliability Standard shall take effect "when approved by the Commission."

Commission Conclusion

381. We decline to make the requested change because, in accepting a Reliability Standard, the Commission may find it necessary to phase-in certain requirements due to the costs and difficulties of implementation, or because a sudden changeover could have a negative impact on reliability. Therefore, we decline to change the Final Rule from "as" to "when."

d. Remand of a Proposed Reliability Standard

382. The FPA authorizes the Commission to remand a proposed Reliability Standard to the ERO if it determines that it does not meet the legal standard of review. The NOPR attempted to better define the precise nature of this remand authority, as well as the requirements for international coordination of remand, and for setting deadlines on remand.

i. Remand

383. Consistent with the statute, the NOPR proposed that the Commission would remand to the ERO for further consideration a proposed Reliability Standard or proposed modification to a Reliability Standard that the Commission disapproves in whole or in part.

Comments

384. NERC comments that, while it supports the proposed remand provision, the Commission is not authorized to rewrite the rejected Reliability Standard. Rather, the ERO should be able to apply its technical expertise to all phases of the drafting of a proposed Reliability Standard.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

385. IEEE recommends that, when remanding a proposed Reliability Standard or a proposed modification to an existing Reliability Standard, the Commission make clear any technical objections that it has with the proposal so that its concerns may be properly addressed on remand.

386. South Carolina E&G and Southern ask the Commission to clarify that the ERO, when deliberating on a remanded Reliability Standard, must allow affected parties to fully participate through an ANSI-certified stakeholder process.

387. Old Dominion states that the Commission should not only be able to remand a proposed Reliability Standard but also be allowed to reject it. However, the Commission should only reject or remand a proposed Reliability Standard if an interim Reliability Standard is in place, or if the proposed Reliability Standard does not address a vital reliability concern. It states that, where the Commission rejects or remands a proposed Reliability Standard, it should do so with specific direction for a revised or alternative Reliability Standard to be proposed within a reasonable time.

388. SERC, TVA, and Santee Cooper recommend that the Commission not remand a Reliability Standard absent a clear showing of a failure of the ERO's Reliability Standard approval process because a Reliability Standard proposed by the ERO will have already been through due process with open participation by all stakeholders.

389. Hydro-Québec comments that the Commission should remand a Reliability Standard to the ERO only if the ERO is the only entity permitted to propose a Reliability Standard to the Commission. However, if a Regional Entity may submit a proposed

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Standard directly to the Commission, the Commission should remand the proposal to the Regional Entity.

Commission Conclusion

390. The Commission adopts the substance of the NOPR's provisions on remand of a proposed Reliability Standard. We will either accept or remand a proposed Reliability Standard. If we remand a proposed Reliability Standard or a proposed modification to a Reliability Standard, we intend to specify our concerns so that the ERO can address them. We disagree with SERC and others that the Commission should not remand a proposed Reliability Standard or a proposed modification to a Reliability Standard absent a clear showing of a failure of the ERO's Reliability Standard development process. Because the Commission has a responsibility to ensure that a proposed Reliability Standard or modification to a Reliability Standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest—as well as assess its effects on competition—we will not so limit our ability to remand.

391. Old Dominion does not explain the meaning of a "rejected" Reliability Standard or the difference between remand and rejection. We assume Old Dominion refers to a proposed Reliability Standard that we find to be wholly inappropriate. In the unlikely event of such a rejection, the Commission would provide any specific direction necessary to ensure that reliability is protected.

392. Hydro-Québec's concern is moot because a Regional Entity cannot submit a Reliability Standard directly to the Commission.

ii. International Coordination of Remands

393. The NOPR asked for comment on whether the Final Rule should specify a process for notifying all relevant regulatory authorities when a proposed Reliability Standard is remanded to ensure that all concerns of such regulatory authorities are addressed prior to resubmission of the Reliability Standard.[97] The NOPR also asked commenters to discuss the implications of the remand by an authority in Canada of a Reliability Standard that has been approved by the Commission.

Comments

394. All commenters agree that international coordination on remand of a Reliability Standard is extremely important. They differ on whether the Commission should address such coordination in the Final Rule or whether this issue is better addressed at the time the ERO files its application. As a third option, some Canadian commenters suggest that coordination between Canadian and United States jurisdictions is more properly the subject of an international agreement directly between the respective regulatory authorities. Further, commenters differ on whether an approved Reliability Standard should go into effect if an authority in another country remands the Reliability Standard.

395. BCTC, SoCalEd, and PSEG Companies believe that the Final Rule should require the ERO to notify all relevant regulatory authorities when a proposed Reliability Standard has been remanded by any one of them. Alcoa states that the Commission should specify

[97] NOPR at P 57.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

a process for the resolution of conflicts between the Commission and Canadian authorities. Hydro-Québec recommends that the Final Rule establish only general principles for coordination because overly prescriptive directives could jeopardize the ERO's ability to harmonize Reliability Standards across international borders.

396. In contrast, EEI and NERC state that the Final Rule should not specify a process by which the ERO must coordinate among the relevant regulatory authorities but, rather, an ERO applicant should propose an approach in its ERO application. APPA states that the ERO should be free to negotiate procedures and substantive rules with Canadian and Mexican authorities based on their own statutory requirements. Ontario IESO states that international coordination is best addressed by an agreement between authorities.

397. Some commenters express views on whether a Reliability Standard approved by the Commission but remanded by Canadian authorities should be enforceable in the United States. EEI states that, in such a scenario, the Commission should ensure that there is no gap in its application within the United States while Canadian concerns are being addressed by the ERO. Alberta and the ISO/RTO Council comment that a remand in one jurisdiction should not necessarily negate enforcement of a Reliability Standard in another. However, the remand of a proposed Reliability Standard by the Commission will require the ERO to revisit it and address the concern of all relevant authorities. Similarly, Ameren and FRCC do not believe that a Canadian remand would bind the Commission.

398. National Grid and MRO take the opposite view and state that a proposed Reliability Standard should not become effective until all affected countries have

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

approved it. National Grid comments that, without explicit coordination among regulatory officials of all affected countries, a proposed Reliability Standard could be accepted in one jurisdiction but remanded in another, which could lead to the untenable situation of having different Reliability Standards apply to different parts of the same grid. The interconnected grid cannot be operated or used in accordance with multiple, inconsistent Reliability Standards.

399. Commenters support international coordination not only at the remand stage, but also stress that consultation among authorities in the Reliability Standard development process will reduce the likelihood of a remand in one country but not the other.[98] The ISO/RTO Council comments that preventing conflicts between jurisdictions should be an integral, high-priority element of the procedures and stakeholder processes employed by the ERO and Cross-Border Regional Entities in developing a proposed Reliability Standard. When first evaluating a proposed Reliability Standard, the Commission should consider whether the ERO has determined that all other affected jurisdictions can implement the Reliability Standard. Hydro-Québec emphasizes the importance of integrating Canadian perspectives into the ERO's Reliability Standard development process.

[98] See, e.g., BCTC, CEA, ISO/RTO Council, MRO and National Grid.

Commission Conclusion

400. The ERO will be an international organization that must seek recognition in Canada and Mexico. Thus, we agree with commenters that international coordination is important to the Reliable Operation of the Bulk-Power System. Therefore, we direct the ERO applicant to propose in its certification application an approach for international coordination regarding the remand, as well as the initial development, of a Reliability Standard that will apply in each relevant country.

iii. Deadline for Submitting a Revised Proposal for a Reliability Standard in Response to a Remand

401. The NOPR proposed that the Commission, when remanding a proposed Reliability Standard, may state a deadline by which the ERO must resubmit the proposed Reliability Standard with revisions that address the reasons for the remand.[99] The NOPR stated that the failure to meet such a deadline would constitute a violation of the FPA.

Comments

402. While a few commenters agree that the Commission is authorized to set a deadline, most caution that strict enforcement of deadlines either will interfere with international coordination or violate the requirement for openness and balance of interests in the ERO's Reliability Standard development process.

403. NARUC and the Ohio Commission comment that, while imposing a deadline for resubmitting a remanded Reliability Standard may be within the scope of the

[99] NOPR at P 53.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission's authority, the Commission should exercise caution in using that authority so as not to interfere with the ERO's Reliability Standard development process.[100] NARUC states that the integrity of the existing process rests on balanced stakeholder input, which in turn depends on notice and opportunity for comment.

404. APPA comments that it may be appropriate for the Commission to set a deadline for resubmission of a proposed Reliability Standard but expresses concern that the deadline must be reasonable. South Carolina E&G recommends that the Commission should allow a minimum of six months. NiSource urges flexibility in setting deadlines

405. CEA and Alberta comment that the remand provision is a key factor in allowing the ERO to function on an international basis, and imposing a deadline for consideration of a remanded Reliability Standard could compromise the ERO's ability to coordinate with the various jurisdictional authorities. By allowing the industry-based organization to work with its regulatory agencies, the remand process is intended to ensure that no one regulatory body can impose a Reliability Standard outside of its jurisdiction.

406. MRO contends that a failure by the ERO or a Regional Entity to meet a Commission deadline should not be considered a violation of the FPA. MRO believes that the Commission's authorities to decertify the ERO and revoke a Regional Entity's delegation agreement are more appropriate for ensuring that Commission-imposed deadlines are met. Also, because the ERO and Regional Entities will most likely be

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[100] See also APPA, MidAmerican, South Carolina E&G and Xcel Energy.

organized as nonprofit organizations, monetary penalties will have to be passed along to those entities subject to the Reliability Standards.

407. MidAmerican states that the Commission should not impose a penalty for failure to meet a deadline if the ERO demonstrates good faith progress and provides a reasonable schedule for completion.

Commission Conclusion

408. Timely attention to the reliability needs of the Bulk-Power System requires that the Commission have appropriate procedural tools to guide the ERO through a timely Reliability Standard remand process. Such procedural tools, while not specified in detail in new section 215 of the FPA, are both necessary and fully consistent with the authorities expressly granted to the Commission by statute. The Final Rule contains Commission authority to set a deadline on remand at section 39.5(g). Any necessary deadline will be established in a reasonable manner taking into consideration the complexity of the issue.

409. The Commission recognizes the benefit of coordination with relevant Canadian and Mexican authorities on remand, including consideration of a deadline. Accordingly, if we remand an ERO-proposed Reliability Standard, we will consider the time needed for Canadian and Mexican authorities to act also.

410. We appreciate APPA's comment about the reasonableness of a deadline; we will consider the time needed for a proposed revision to go through the ERO’s process as well as any need to have an enforceable Reliability Standard in a timely manner. The ERO

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

applicant should specifically propose an accelerated process for addressing a Reliability Standard that has been remanded with a specific deadline.[101]

411. We disagree with MRO and reaffirm our interpretation that a failure to meet a Commission-imposed deadline would be considered a violation of the FPA. The ability to set a deadline derives from the Commission's authority to remand a proposed Reliability Standard together with our authority under section 215(e)(5) to take such action as is necessary or appropriate against the ERO or a Regional Entity to ensure compliance with any Commission order affecting the ERO or a Regional Entity.

412. As to the recommendation of MidAmerican that the Commission defer imposing a penalty while the ERO or Regional Entity is making a good-faith effort, we repeat that we will be flexible and reasonable in setting deadlines. However, should we determine that a deadline is necessary and the ERO fails to comply with the deadline we have established, we reserve the authority to impose a penalty according to the FPA.

e. Commission-Initiated Actions on a Reliability Standard

i. Commission Directive that the ERO Address a Specific Issue

413. The NOPR proposed that the Commission may, upon its own motion or a complaint, order the ERO to submit a proposed Reliability Standard or a proposed modification to a Reliability Standard that addresses a specific matter if the Commission

[101] For example, NERC's existing ANSI-certified process incorporates an "urgent action" procedure, which allows an interim reliability standard to be developed more quickly.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

considers such a new or modified Reliability Standard appropriate to carry out section 215 of the FPA.

Comments

414. EEI comments that, while the Commission may determine that a particular reliability issue should be addressed by the development of a Reliability Standard, it should use the ERO's Reliability Standard development process to implement its determination.

415. Santa Clara recommends that the Final Rule expressly include a clear, fair and meaningful petition process that would enable any interested person to petition the Commission or the ERO to add or revise a Reliability Standard. The ERO and the Commission would retain the discretion whether or not to accept an outside party's request for the adoption of a new or revised Reliability Standard.

Commission Conclusion

416. Section 39.5(f) of the Final Rule accommodates these two comments. First, the Commission's authority to order the ERO to address a particular reliability topic is not in conflict with other provisions of the Final Rule that assign the responsibility for developing a proposed Reliability Standard to the ERO.

417. Second, section 39.5(f) of the Final Rule authorizes the Commission to act on its own motion or upon "a complaint." The Commission may direct the ERO to propose a new Reliability Standard in response to a complaint. The ERO, as the entity responsible for the development of Reliability Standards, should normally be approached first with a request to initiate a new Reliability Standard to address a particular issue. As we discuss

above, the ERO's Reliability Standard development process must be open to public participation.

ii. Review of an Approved Reliability Standard

418. The NOPR proposed that the Commission, upon its own motion or complaint, may review a previously-approved Reliability Standard and order the ERO to modify it if it no longer satisfies the statutory standard of review.[102]

Comments

419. NERC comments that, while the NOPR would allow to the Commission to direct either the ERO or a Regional Entity to modify a Reliability Standard, the Commission should direct only the ERO because the ERO is the only entity that directly submits a proposed Reliability Standard to the Commission for approval. Further, EPAct does not provide for a request for modification to a Regional Entity.

420. APPA comments that the Commission must send a previously-approved Reliability Standard to the ERO and the Commission cannot change the Reliability Standard. It states that, in reviewing a previously-approved Reliability Standard, the burden of proof must rest on the party seeking to change or overturn the Reliability Standard. Also, after a previously-approved Reliability Standard is sent for modification, it should remain enforceable until the replacement is approved and in effect—unless the

[102] While the proposed regulation allows a remand to the ERO, the NOPR, at P 52, states that the Commission may remand the Reliability Standard to the ERO or the relevant Regional Entity.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission determines that Bulk-Power System reliability is better served by not having and enforcing the Reliability Standard.

421. Similarly, Xcel Energy recommends that when ordering a modification of a previously-approved Reliability Standard, to avoid a period with no Reliability Standard in place, the Commission should grant a grace period for the ERO to propose a modification to the Reliability Standard. During that period, the original unmodified Reliability Standard would be in effect.

422. LADWP states that the Commission should order the ERO to submit a modification only after notice and opportunity for hearing, and after having found that the Reliability Standard is unjust, unreasonable or unduly discriminatory and not in the public interest.

Commission Conclusion

423. The Commission adopts the proposal that the Commission may review a previously-approved Reliability Standard and order the ERO to modify it if it no longer satisfies the statutory standard of review as proposed. We agree with NERC that the Commission should order only the ERO to modify a Reliability Standard because the ERO is the only entity that may directly submit a proposed Reliability Standard to the Commission for approval. There is no change needed in the text of the proposed regulations because they provided that the Commission may order only the ERO to modify a Reliability Standard.

424. We agree with APPA that the Commission cannot change the Reliability Standard and must send the Reliability Standard to the ERO for modification.

425. Regarding the comments of APPA and Xcel Energy that the existing Reliability Standard should remain enforceable until a replacement is approved, we agree. However, in the rare case of a Reliability Standard that is causing harm to the Bulk-Power System we expect all interested persons to cooperate in a process to correct the approved Reliability Standard as soon as possible.

426. We reject the proposition of LADWP that special procedures must apply to the action of the Commission on its own motion.

iii. Commission Authority to Void a Reliability Standard

427. The Commission asked for comments on whether it has authority to void a previously-approved Reliability Standard and, if so, whether it is beneficial to have such a provision in the Commission's regulations.[103]

Comments

428. Most commenters caution the Commission against claiming the authority to void a previously-approved Reliability Standard, claiming that: (1) it is not permitted by section 215 of the FPA; (2) it is antithetical to the ANSI stakeholder process; and (3) the relationship between individual Reliability Standards is complex so that voiding one Reliability Standard could result in unwanted gaps or conflicts with the remaining Reliability Standards. Other commenters favor the proposal and argue that the authority

[103] NOPR at P 54.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

to void a Reliability Standard is a natural extension of the authorities defined in section 215 of the FPA.

429. NARUC and LADWP do not believe that section 215 of the FPA grants the Commission authority to void a Reliability Standard, in whole or in part, whether new or previously accepted.[104] Section 215 of the FPA authorizes the Commission to approve or remand a proposed Reliability Standard. If the Commission takes issue with an existing approved Reliability Standard, it should direct the ERO to modify the Reliability Standard through its Reliability Standard development process, as provided by statute. Voiding a Reliability Standard would extend beyond the Commission's statutory authority and would be contrary to the approach in section 215. APPA also argues that the Commission lacks the authority to void a previously approved Reliability Standard, with the possible exception of those found to have a substantial negative impact on competition.

430. Progress Energy and others caution the Commission against voiding a previously-approved Reliability Standard that has been developed through an ANSI-approved process, which is open, balanced, and adheres to due process principles.[105] The Commission should not void a Reliability Standard simply because it does not measure up to the Commission's technical or administrative desires. Instead, the Commission

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[104] See also FRCC, MRO, NRECA, Ohio Commission and Southern Companies.

[105] See also MidAmerican, Santee Cooper, SERC, TVA and South Carolina E&G.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

should direct the ERO to modify the Reliability Standard through its Reliability Standard development process.

431. CEA, NARUC and the New York Commission claim that the relationships and dependencies between Reliability Standards are complex. If the Commission were to void a previously accepted Reliability Standard, the result might interfere with the implementation or enforcement of other Reliability Standards. All individual Reliability Standards are parts of a complex whole designed to maximize overall reliability.

432. A number of commenters claim that voiding a Reliability Standard would leave a gap in an area of reliability where the ERO or Regional Entity determined that a Reliability Standard is required.[106] Some add that such a gap could result in operational conflicts between international jurisdictions. International Transmission adds that a change to the Reliability Standards may affect tariffs and contracts. They recommend, as an appropriate alternative, that the Commission remand an approved Reliability Standard for further development in an ANSI-accredited process. Ameren adds that changing a previously-approved Reliability Standard can have serious competitive implications and should only be done for compelling reasons. Hydro-Québec recommends that the authority to void an approved Reliability Standard be restricted to exceptional situations because the ERO will have to fulfill both Canadian and American mandates.

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[106] See, e.g., BCTC, NERC, Ontario IESO, TAPS and South Carolina E&G.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

433. Other commenters believe that the Commission has the legal authority to void a Reliability Standard.[107] Ameren and SoCalEd believe that the Commission, based on its authority to direct the ERO to modify a Reliability Standard, also has the authority to void an approved Reliability Standard. SoCalEd states that the Commission should set guidelines in its regulations and establish a process for voiding a Reliability Standard.

434. NiSource states that it is unclear whether the Commission may void a previously-approved Reliability Standard based on a finding that it no longer meets the legal standard of review. When tariff provisions are found to be unjust or unreasonable, they are generally allowed to remain in effect pending the filing and approval of revised tariff provisions. While NiSource agrees with the Commission's unstated concern that unjust and unreasonable standard should be removed, when and how that happens requires a careful balancing. The Commission should analyze whether the Reliability Standard is so unjust, unreasonable or discriminatory that the Bulk-Power System is better off without it or whether system reliability requires that the Reliability Standard remain in effect pending its replacement. NiSource proposes that if a Reliability Standard is found to be unjust, unreasonable or discriminatory but remains in place pending its replacement, then no penalties should be imposed for violations of that Reliability Standard during that period.

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[107] See, e.g., Ameren, EPSA, ERCOT, Old Dominion, PacifiCorp and SoCalEd.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission Conclusion

435. The Commission does not adopt a provision in the regulations for the Commission to void an approved Reliability Standard. If in the future, a situation arises in which it may be appropriate to remove immediately an existing Reliability Standard that is determined to do more harm than good, we may consider at that time whether to void a previously-approved Reliability Standard.

6. Conflict of a Reliability Standard with a Commission Order – Section 39.6

436. Section 215(d)(6) of the FPA requires that the Commission's Final Rule include "fair processes for the identification and timely resolution of any conflict between a reliability standard and any function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission applicable to a transmission organization." Consistent with this requirement, the Commission proposed regulations which provided such processes, such as for a Transmission Organization expeditiously to notify the Commission, the ERO and the relevant Regional Entity of a conflict between a Reliability Standard and the Transmission Organization's Commission-approved function, rule, order, tariff, rate schedule, or agreement.[108] The proposed section sets a 60-day deadline, subject to Commission waiver, for the Commission to act on a notification of a potential conflict.

[108] NOPR at P 87-90.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

437. In the NOPR, the Commission asked for examples of situations or areas of concern in which commenters believe that a conflict between a Reliability Standard and a Transmission Organization function, rule, order, tariff, rate schedule, or agreement exists or may arise.[109]

Comments

438. The ISO/RTO Council and NERC believe that potential conflicts could be identified and resolved in an open Reliability Standard development process. Similarly, EEI suggests that the Commission require a Transmission Organization to raise any concern regarding a potential conflict during the Reliability Standard development process as a condition precedent to a Transmission Organization invoking the Commission's proposed process for resolving Reliability Standard-related conflicts.

439. American Transmission asserts that there may be situations where a new or modified Reliability Standard affects the economic terms of a tariff. It suggests that, in such a situation, the Commission would either have to change the economic terms of the tariff or change the Reliability Standard's application to ensure a just and reasonable, and nondiscriminatory result. In contrast, International Transmission asserts that, because the Commission's first concern should be reliability, when a Reliability Standard is in conflict with a tariff, the tariff should be revised, not the Reliability Standard.

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[109] Id. at P 91.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

440. FirstEnergy argues that the proposed conflict resolution process should extend to a pre-Order No. 888 grandfathered agreement of a member of an RTO. It contends that the phrase "applicable to any transmission organization," as used in section 215(d)(6) of the FPA, should be interpreted to include any requirement that affects the transmission or generation facilities of an entity that is a member of the transmission organization, regardless whether the Transmission Organization is a party to the agreement.

441. Commenters ask the Commission to include procedures for other circumstances that may arise. Oklahoma Commission asks the Commission to establish a process for responding to an emergency situation in which a lapse in Bulk-Power System reliability results from an entity having to deal with conflicting authorities. International Transmission suggests that the Commission establish an expedited process for tariff changes required because of a conflict with a Reliability Standard. Furthermore, it states that a tariff revision that is required due to a conflict with a Reliability Standard should not open the remainder of the entity's tariff to review. FirstEnergy suggests that the Commission and the ERO provide a process for resolving a conflict between a Reliability Standard and any other regulatory or contractual obligation of a Bulk-Power System user.

442. The Texas Commission supports the proposed process to address a potential conflict between a Reliability Standard and a Commission-approved tariff. It contends, however, that ERCOT would not be subject to the proposed provision since ERCOT's market rules are not approved by the Commission.

443. In response to the Commission's inquiry, a few commenters offer examples of conflicts. NERC states that, aside from specific variances that are included in NERC's

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

current version "0" reliability standards, it is not aware of any conflict between its current standards and a Transmission Organization tariff. The ISO/RTO Council comments that, in the past, conflicts have arisen between market rules and NERC's reliability requirements for transmission loading relief procedures, tagging rules, and the requirement for reliability-based ancillary services such as voltage support.

Commission Conclusion

444. As discussed below, the Final Rule adopts the substance of the proposed regulations on conflicts with a Reliability Standard as section 39.6. We agree with commenters that a potential conflict between a Reliability Standard under development and a Transmission Organization function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission should be identified and addressed during the ERO's Reliability Standard development process. Although we encourage parties to follow EEI's proposal that a Transmission Organization should have to raise a concern regarding a potential conflict during the Reliability Standard development process, we will not require it in this Final Rule. Such a condition would preclude a Transmission Organization from invoking the procedure if a potential conflict is first recognized after a Reliability Standard has been approved. EEI's proposal would also preclude a Transmission Organization from notifying the Commission pursuant to section 39.6 in a situation where the Transmission Organization finds that a new or modified tariff potentially conflicts with an existing Reliability Standard.

445. While we agree with International Transmission regarding the paramount importance of maintaining Bulk-Power System reliability, we do not agree that every

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

conflict between a Reliability Standard and a Transmission Organization tariff must be resolved by changing the tariff. A modification of a Reliability Standard to resolve a conflict may be accomplished without necessarily compromising Bulk-Power System reliability. We will decide on a case-by-case basis the appropriate manner of resolving such a conflict.

446. With regard to FirstEnergy's comment, we reserve judgment on whether the process prescribed in section 39.6 should extend to an RTO member's pre-Order No.888 grandfathered agreements. The Commission understands the phrase "applicable to any transmission organization," as used in section 215(d)(6) of the FPA, to limit the provision to a Transmission Organization function, rule, order, tariff, rate schedule, or agreement, thus not applying to the resolution of a potential conflict with agreements to which the Transmission Organization is not a party or other non-Transmission Organization agreements or tariffs via the process prescribed in section 39.6. The Commission recognizes that pre-Order No. 888 grandfathered agreements can be complex, and for that reason, we are not making a generic determination at this time. We will, however, consider on a case-by-case basis whether the conflict resolution process, as prescribed in section 39.6, should be extended to an RTO's member's pre- Order No. 888 grandfathered agreements when an actual conflict is identified.

447. With regard to the Oklahoma Commission's and International Transmission's comments, we do not establish here a separate generic procedure to expedite resolving a potential conflict between a Reliability Standard and a Transmission Organization tariff. A Transmission Organization may request expedited treatment of a filing, however, and

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the Commission will consider such a request on a case-by-case basis. We agree with International Transmission that a proceeding to resolve a potential conflict should not normally address tariff issues unrelated to the potential conflict. However, the Commission recognizes that it is possible that a reliability-related change to a Transmission Organization's tariff may upset a negotiated balance within the tariff. In those instances, the Commission may allow tariff issues unrelated to the potential conflict to be resolved.[110]

448. With regard to the Texas Commission's comments, we agree that section 39.6 applies only to a potential conflict between a Reliability Standard and a Commission-approved tariff, precluding its use for the resolution of a potential conflict involving tariffs, market rules, etc. that are not subject to Commission approval.[111]

449. With regard to FirstEnergy's suggestion that the Commission and the ERO provide a process for resolving a conflict between a Reliability Standard and any other regulatory or contractual obligation of a Bulk-Power System user, such a process is outside the scope of this proceeding. However, this decision does not preclude a Transmission Organization from identifying a potential conflict during the Reliability Standard development process or at other times and taking steps to seek resolution of the matter before the appropriate regulatory authority. Nor does this prejudice the rights

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[110] See also Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators, 111 FERC ¶ 61,009 (2005).

[111] See, infra, section IV.B.12, State Actions.

under other provisions of the FPA of any user, owner or operator of the Bulk-Power System to notify the Commission about a conflict between a Reliability Standard and any function, rule, order, tariff, rate schedule, or agreement ordered or approved by the Commission.

7. Enforcement of Reliability Standards – Section 39.7

450. The proposed section in the NOPR on Enforcement of Reliability Standards addressed compliance and enforcement issues.[112] The proposal would implement the enforcement provisions of section 215(e) of the FPA, which authorize the ERO to impose a penalty for a violation of a Reliability Standard, subject to an opportunity for Commission review. The term "penalty" as used throughout the NOPR included both monetary and non-monetary penalties, unless specifically stated otherwise.[113]

451. Consistent with the statute, the proposed enforcement regulations would allow the ERO or a Regional Entity with delegated enforcement authority to impose a penalty on a user, owner or operator of the Bulk-Power System for a violation of a Reliability Standard.

452. The NOPR provided that a penalty imposed by an ERO or a Regional Entity may not take effect until the 31st day after a notice of the penalty is filed with the Commission. The NOPR proposed that either the ERO or a Regional Entity may file

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[112] NOPR at P 58-62.

[113] We also include both monetary and non-monetary penalties in the term "penalty" throughout the Final Rule, unless specifically stated otherwise.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

such a notice with the Commission. The alleged violator, or the Commission on its own motion, may seek review of the penalty within 30 days after the notice is filed with the Commission.

453. The following discussion generally follows the stages of the enforcement process, first addressing compliance matters such as enforcement audits, voluntary compliance programs and compliance directives. Next, we address investigations by the ERO or a Regional Entity, including matters such as due process, followed by a discussion of various aspects regarding the imposition of penalties, such as appropriate non-monetary penalties, limits on monetary penalties and the need for the ERO to develop penalty guidelines. The Final Rule then discusses ERO reports of alleged violations and Commission review of penalties imposed by the ERO or a Regional Entity, including matters related to the nonpublic treatment of investigations and Commission proceedings. Finally, the issue of appeals and other enforcement-related matters are discussed.

a. General Comments on Enforcement

454. Several commenters emphasize that penalties and sanctions may not necessarily improve compliance or reliability and are concerned that entities may simply view a penalty as a cost of doing business if it is set too low or imposed so often that it is viewed as unavoidable.[114] They propose that the Final Rule explicitly recognize that the goal of a

[114] See, e.g., Ohio Commission, International Transmission and Michigan Electric.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

penalty is to create an incentive for compliance. They urge the Commission to monitor the effectiveness of penalties and revise or revoke an ineffective penalty.

Commission Conclusion

455. The Commission concurs that the fundamental goal of mandatory, enforceable Reliability Standards and related enforcement programs is to promote behavior that supports and improves Bulk-Power System reliability. A monetary penalty must be assessed and structured in such a way that a user, owner or operator of the Bulk-Power System does not consider its imposition as simply an economic choice or a cost of doing business. Further, a non-monetary penalty should be structured to encourage or require compliance and improve reliability by regulating the behavior of the entity subject to the penalty. In its oversight role, the Commission plans to monitor the effectiveness of enforcement penalties, both monetary and non-monetary.

b. Compliance

456. The term "enforcement" in the context of this Final Rule includes both pro-active compliance efforts by the ERO or a Regional Entity as well as after-the-fact investigations and imposition of penalties. The ERO and Regional Entities are expected to have a compliance program for ongoing monitoring of user, owner and operator compliance with Reliability Standards. Compliance activities such as enforcement audits, best-practices programs and remedial action are discussed below.

i. Enforcement Audits of Compliance with Reliability Standards

457. The NOPR asked whether the proposed rule should specify any enforcement audit requirements to be included in the ERO certification requirements and the Regional Entity delegation requirements.

Comments

458. Numerous commenters state that they support the bilateral principles on the subject of enforcement audits[115] and would support the inclusion of such audit requirements in the Commission's Final Rule.[116] Santee Cooper and SERC comment that the Final Rule should specify an enforcement audit process "hierarchy" under which the Commission audits the ERO; the ERO audits the Regional Entities, and the Regional Entities audit entities responsible for compliance with Reliability Standards.

459. Some commenters add that the Commission should allow an ERO or Regional Entity candidate to propose enforcement-related auditing procedures in a certification application and delegation agreement, respectively.[117] NERC recommends the inclusion

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[115] NOPR at P 71 (enforcement question 8). The bilateral principles, at 3, provide that: (1) the ERO and Regional Entities should conduct rigorous audits to ensure both the capability to comply and actual compliance with Reliability Standards; (2) audits should meet relevant auditing standards; (3) the ERO should take steps to ensure that auditors are properly trained; and (4) the same audit standards apply to all audits conducted by the ERO and Regional Entities.

[116] See, e.g., AEP, Ameren, CEA, ELCON, ERCOT, FRCC, MRO, NERC, New York Companies, SERC, SoCalEd, South Carolina E&G and TVA.

[117] See, e.g., AEP, EEI, International Transmission, Southern and SoCalEd.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

of a requirement that the ERO develop and approve enforcement audit requirements in the Regional Entity delegation agreements. NERC states that it expects both the certification and readiness audit programs to include general audit criteria. Similarly, the New York Companies suggest that the Final Rule require that compliance with Reliability Standards be audited, but not specify in detail how the audits are to be performed. Kansas City P&L comments that the Final Rule should include criteria for the auditors of the ERO or a Regional Entity but that the ERO should have discretion with respect to the particulars of enforcement audit requirements.

460. CEA and Alberta state that uniform enforcement auditing standards should be required in the ERO's certification application to ensure that the ERO has the necessary tools in place to maintain a reliable transmission grid. In addition, Alberta suggests that the ERO should rebuttably presume that enforcement audits conducted by WECC, as a Regional Entity organized on an Interconnection-wide basis, follow consistent procedures for rigorous auditing. Further, Alberta states that the Commission should permit WECC to have compliance monitoring and enforcement procedures that do not necessarily conform to other regions.

461. EEI states that a comprehensive enforcement audit program is the first line of prevention and explains that the ERO and Regional Entities should have flexibility in tailoring audits for different circumstances. EEI suggests that the Commission consider requiring the ERO to use a certified audit program, to be included in an ERO application or Regional Entity delegation agreement, which is subject to independent audit by relevant regulatory authorities. Likewise, PSEG Companies recommend that the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission allow the ERO and Regional Entities, through their stakeholder processes, to determine the best approach to enforcement audits.

462. APPA supports the implementation of audit standards but suggests that, initially, they be provisional in nature to allow flexibility in adjusting audit standards based on hands-on experience and regional differences determined during the initial audits.

Commission Conclusion

463. The Commission agrees with the commenters that support the need for rigorous enforcement audits of users, owners and operators of the Bulk-Power System by well-trained auditors applying consistent audit standards. The Commission finds that an effective enforcement audit program is a necessary component of the requirement that the certified ERO have the ability to develop and enforce Reliability Standards, set forth in section 215(c)(1) of the FPA. Any Regional Entity that receives a delegation of enforcement functions also must have in place an audit program. Accordingly, the Final Rule includes a new section 39.7(a) that requires the ERO and Regional Entities to "develop an audit program that provides for rigorous audits of compliance with Reliability Standards by users, owners and operators of the Bulk-Power System."

464. The ERO shall submit the initial enforcement audit program, as well as any significant change, to the Commission for review and approval. We intend the enforcement audit program to be a single program applicable to both the ERO and Regional Entities unless there is a compelling reason for a difference between the ERO and a particular Regional Entity. Such programs must not vary significantly from region to region unless good cause is shown for such differences.

ii. Reliability-Related Programs

465. The NOPR asked a series of related questions regarding whether the Commission and/or the ERO should adopt features of the Nuclear Regulatory Commission's (NRC) and the Institute of Nuclear Power Operations' (INPO) reliability-related programs, such as the NRC Action Matrix and nuclear power plant assessment program, and the INPO information sharing network, equipment failure database and monitoring of performance indicators.[118]

Comments

466. Some commenters favor the ERO developing a program similar to those utilized in the nuclear industry.[119] Xcel Energy and others express concern that some or all of the nuclear industry programs are either inapplicable to electric transmission or unnecessarily duplicative of existing programs. EEI, Entergy and others comment that it is premature to establish a watchlist or other INPO-type features and the Commission should first get experience with the ERO process before such decisions are made. A number of commenters urge that, to the extent that any such program is developed, it should be developed by the ERO on a voluntary basis without a Commission mandate.[120]

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[118] NOPR at P 72-73.

[119] See, e.g., APPA, NASUCA, Southern and SERC (supporting development of a reliability "watchlist"); AEP, American Transmission, EEI, Kansas City P&L and TVA (supporting development of an "INPO-type best practices" program).

[120] See, e.g., Progress Energy, Santee Cooper and South Carolina E&G.

Commission Conclusion

467. We understand that the performance-oriented, results-driven aspects of such programs would serve as useful models for the ERO and the electric industry. For example, "best practices," as applied in the nuclear industry, are the basis of the INPO program for evaluation of a nuclear generating plant. The best practices program focuses on the plant meeting performance objectives based on the industry's best practices for excellence in the operation of a nuclear generating plant. Similarly, aspects of INPO's other core reliability-related programs, which include, for example, personnel training and accreditation, events analysis and information sharing, and proactive assistance for generating plants that have indications of declining performance, have enabled the nuclear industry to improve all facets of nuclear plant operations. Such models may have application for the ERO and electric industry reliability.

468. The Commission believes that programs of the NRC and INPO such as an action matrix, compliance watch-list or "best practices" program would enhance Bulk-Power System reliability. Such programs would be most effective if developed by the ERO and approved by the Commission. We agree with EEI and others that it is appropriate to first establish the ERO and then use its Commission-approved procedures to develop such programs. The Commission will require the certified ERO to make a compliance filing no later than one year from the date of certification proposing reliability enhancement programs that would improve Bulk-Power System reliability, along with a program implementation schedule. The ERO may propose such a reliability enhancement program earlier than one year from certification.

iii. Remedial Action

469. The NOPR did not directly discuss the authority of the ERO or a Regional Entity to take "remedial" action, with the goal of bringing a noncompliant entity back into compliance. Nonetheless, a number of commenters discuss the ERO's and a Regional Entity's need to take remedial action, distinct from a non-monetary penalty.

470. To place these comments in context, we first discuss generally remedies and non-monetary penalties. If an entity violates a legal requirement, one remedy is to place the violator into compliance prospectively. Ending a violation or preventing future violations does not penalize the violator but instead seeks to return it to compliance.[121] A directive to stop a violation, i.e., a compliance directive, is one type of remedy. Staff training may be another type of remedy. In contrast, a penalty is imposed to punish a violator. Penalties may be monetary, such as a civil penalty or a fine, or non-monetary. As appropriate here, a non-monetary penalty may include limitations on activities, functions, or operations, or other appropriate sanctions.[122]

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[121] Cf. U.S. v. Telluride Co., 146 F.3d 1241 (10th Cir. 1998) (For purpose of determining whether the statute of limitations in 28 U.S.C. § 2462 for penalty assessments applied, injunctive relief was not a penalty.)

[122] FPA section 215(c)(2)(C).

Comments

471. A number of commenters state that, generally, remedial action should focus first on bringing an entity back into compliance.[123] For example, American Transmission comments that the "penalty" structure should provide first for mitigation of the violation, second for correction of behavior and third for punishment for behavior. EEI suggests that compliance actions may be very effective in assuring future compliance with Reliability Standards, and that compliance efforts should precede monetary penalties.

472. TAPS emphasizes that only a penalty, and not a compliance directive, should be subject to the 31-day waiting period set forth in section 215(e)(2) of the FPA. APPA also comments that the ERO should have the authority to issue directives to cease and desist from a violation, which APPA views as different from a non-monetary penalty.

473. NERC comments that the ERO should be able to take action outside of the penalty process to bring an entity into compliance with a Reliability Standard. NERC mentions several examples of such action, including directing the development of a remediation plan, increased auditing of an entity displaying marginal performance, increasing training requirements to correct an operating problem, or sending a letter to an industry CEO to draw executive attention to a problem relating to the CEO's company.

474. Commenters differ on whether certain actions by the ERO or a Regional Entity would constitute a non-monetary penalty versus a compliance or remedial action. For

[123] See, e.g., American Transmission, EEI, Hydro One, NYISO and TAPS.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

example, when responding to the NOPR's request for comments on appropriate types of non-monetary penalties, some commenters identified the following actions by the ERO or a Regional Entity as a type of non-monetary penalty: disclosure of a confirmed violation; informing an industry CEO of a noncompliance matter; and notifying a regulatory authority of an entity's noncompliance.[124] Other commenters, however, characterized these actions as remedial.[125]

Commission Conclusion

475. We agree with commenters that the ERO or a Regional Entity may take certain actions with the intent of bringing an entity into compliance with a Reliability Standard rather than to penalize the entity for its noncompliance. As discussed above, the Commission concludes there is a distinction between a remedial action versus a non-monetary penalty. The ERO or a Regional Entity may take remedial action to bring a user, owner or operator of the Bulk-Power System into compliance with a Reliability Standard. One example of a remedial action is a compliance directive. The ERO or Regional Entity may conclude, based on the evidence available to it, that an entity is violating a Reliability Standard and may issue a compliance directive to the entity that it stop its violation and come into compliance with the Reliability Standard. A compliance directive may establish a timetable for compliance.

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[124] See, e.g., MRO, Progress Energy, Santee Cooper, SERC and TVA.

[125] See, e.g., APPA and TAPS.

476. We agree with TAPS that a compliance directive differs from a penalty. An ERO or Regional Entity compliance directive is a directive that a user, owner or operator comply with a Reliability Standard. A compliance directive is a remedial action, not a penalty, and thus does not have to satisfy the 31-day waiting period (related to the imposition of a penalty) to take effect. The ERO or Regional Entity must inform the Commission of any compliance directive pursuant to section 39.7(b).

477. Likewise, the ERO or a Regional Entity may take other remedial actions without having to satisfy the 31-day waiting period that applies to a penalty. For example, if the ERO or Regional Entity conclude, based on the evidence available to it, that an entity is violating a Reliability Standard, it may take remedial actions such as informing an industry CEO of a violation of a Reliability Standard, notifying a relevant regulatory authority, directing a user, owner or operator to develop and comply with a remediation plan, and imposition of increased auditing or additional training requirements. Further, pending completion of its investigation, the ERO or a Regional Entity may informally notify an entity, orally or in writing, that the entity appears to be violating a Reliability Standard and request that the entity stop that activity or otherwise return to compliance with the Reliability Standard. The ERO or Regional Entity must inform the Commission of any remedial actions pursuant to section 39.7(b).

478. We agree with commenters that, as a general matter, ERO or Regional Entity action should bring a user, owner or operator into compliance. Moreover, penalties, both non-monetary as well as monetary, can be imposed by the ERO or a Regional Entity either in conjunction with, or after, action to bring an entity into compliance. The proper

approach may vary in a particular situation depending on the severity of the violation, the frequency of noncompliance, whether the noncompliance was deliberate and other relevant considerations. When determining the appropriate penalty for violation of a Reliability Standard, the ERO or a Regional Entity may take into account a user's, owner's or operator's failure to meet a deadline for compliance or other provisions of a compliance directive. Further, if the ERO or Regional Entity has not acted to require remedial action to bring a user, owner or operator into compliance, has not imposed a penalty, or has ordered remedial action but not imposed a penalty, and the Commission concludes that remedial action or a penalty is appropriate, the Commission on its own motion may take appropriate action.

479. We direct the ERO to specify in its application these and other types of remedial actions that may be undertaken without invoking the waiting period required for monetary and non-monetary penalties to be imposed. We will allow the ERO and Regional Entities to further clarify the distinction between a remedial action and a non-monetary penalty in the ERO certification application, penalty guidelines (discussed later), or delegation agreement.

c. Assessing a Penalty for a Violation

i. Procedures for Investigations and Penalty Assessments

480. The NOPR proposed that the ERO or a Regional Entity may impose a penalty on a user, owner or operator of the Bulk-Power System for a violation of a Reliability Standard if the ERO or the Regional Entity, after public notice and opportunity for hearing, finds that the user, owner or operator has violated a Reliability Standard and files

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

notice and the record of the ERO's or the Regional Entity's proceeding with the Commission.[126]

Comments

481. NiSource asks that the Commission clarify how the existence of a violation will be brought to the attention of the ERO or a Regional Entity. Further, it suggests that, because an investigation might be initiated by the ERO, a Regional Entity or the Commission, the NOPR leaves open the possibility of forum shopping or duplicative proceedings. NiSource requests clarification of the process by which these entities will inform each other of enforcement investigations to prevent the possibility of multiple proceedings addressing the same violation.

482. FirstEnergy suggests that the Commission establish a three-year statute of limitations for a violation of a Reliability Standard. It contends that a longer period would be needlessly burdensome and not relevant to maintaining current system reliability. Further, a three-year limitation would be consistent with NERC's current data retention policy.

483. Alcoa comments that only the ERO should have the authority to levy penalties and that the enforcement role of Regional Entities should be limited to developing a factual record relating to the imposition of a penalty.

[126] NOPR at P 58.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

484. Hydro-Québec suggests that the Final Rule clarify that the ERO or a Regional Entity will have enforcement authority in a Canadian province only to the extent that the provincial government or its regulatory agency decides to delegate enforcement authority to the ERO or a Regional Entity.

Commission Conclusion

485. As to NiSource's comment, the ERO or a Regional Entity may become aware of a violation through compliance monitoring, periodic audits or self-reporting by the non-compliant entity, among other means. The Commission agrees that the ERO, Regional Entities and the Commission should generally avoid multiple investigations involving the same violation. There may be situations in which it would be appropriate to have concurrent investigations but we expect any such occasions to be rare. In those situations we would coordinate efforts with the ERO or any relevant Regional Entity. The requirement in section 39.7(b) of the Final Rule that the ERO and Regional Entities have procedures to report an alleged violation to the Commission early on in the enforcement process should help prevent inadvertent multiple investigations involving the same violation. We reserve the right to initiate our own investigation on a matter already under investigation by the ERO or a Regional Entity and, if appropriate, direct the ERO or

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entity to refer the matter to us.[127] We do not believe another communication process is needed.

486. As discussed later with regard to Delegation to a Regional Entity, the ERO will retain oversight responsibility for enforcement authority that is delegated to a Regional Entity. Further, the ERO is ultimately responsible for how a Regional Entity conducts investigations. We expect the ERO to set up a uniform process for implementing its enforcement authority to be carried out by a Regional Entity. To ensure that each Regional Entity implements the enforcement program in a consistent manner, we will require each Regional Entity to file a periodic report with the ERO on its enforcement investigations (i.e., identifying its investigations and their dispositions) in a manner to be determined by the ERO in its certification application. This report differs from the periodic summary reports on violations required pursuant to section 39.7(b)(5) in that the report on investigations will specify how a Regional Entity carries out its delegated enforcement authority, rather than identifying the violations themselves. Because it is primarily responsible for enforcement of Reliability Standards, the ERO maintains the right to initiate its own investigation on a matter under investigation by a Regional Entity, and, if appropriate, direct the Regional Entity to refer the matter to the ERO.

[127] December 9, 2005 Technical Conference Tr. at 169-70 (remarks of John Polise, Assistant Chief Counsel for Markets of the Securities and Exchange Commission's Division of Enforcement).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

487. Section 215(e) of the FPA does not create a temporal limit on when an investigation that may culminate in a penalty may be initiated. The general statute of limitations for a civil penalty, 28 U.S.C. § 2462, imposes a five-year limitation period on any "action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." We will exercise prosecutorial discretion in determining whether to pursue an alleged violation based on all the facts presented, including the time elapsed since the violation is alleged to have occurred, and will adhere to the five-year statute of limitations when we seek a civil penalty.[128]

488. The Commission adopts the substance of the proposed regulation that authorizes the ERO or a Regional Entity to impose a penalty after finding that a user, owner or operator violated a Reliability Standard.[129] The Commission rejects Alcoa's suggestion that only the ERO should have authority to levy a penalty subject to Commission approval. Section 215(e)(4) of the FPA provides that the ERO may delegate its authority to enforce a Reliability Standard to a Regional Entity. The ability to impose a penalty is one aspect of enforcement. Thus, the ERO's statutory authority to delegate enforcement

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[128] Prohibition of Energy Market Manipulation, Order No. 670, III FERC Stats. & Regs. ¶ _____ at P 62-63 (January 19, 2006).

[129] As discussed later under the topic of "Confidentiality of Reports," the Final Rule revises the proposed regulation, eliminating the requirement that the ERO or a Regional Entity provide "public" notice of determining whether to impose a penalty. The revised provision at section 39.7(c) requires that an alleged violator receive notice and an opportunity for hearing.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

functions to a Regional Entity includes the delegation of authority to impose a penalty on a user, owner or operator of the Bulk-Power System.

489. With regard to Hydro-Québec's comment, the Commission finds that enforcement authority under section 215(e) of the FPA applies only to violations that occur within the United States. The enforcement authority of the ERO or a Regional Entity in Canada is outside the scope of this proceeding.

ii. Due Process

490. A number of commenters express concern about whether the ERO and Regional Entities will have adequate procedures to ensure due process in considering whether to impose a penalty. For example, PacifiCorp, New York Companies, and LADWP emphasize that due process for parties subject to penalties must be clearly defined for each stage of the penalty process, including protection for alleged violators. EEI states that the Commission must ensure that the ERO and Regional Entities include in their respective applications and agreements a set of compliance processes that meet due process requirements. PG&E asks the Commission to clarify that a notice of violation should provide complete information to which the alleged violator can respond.

491. Some commenters, such as WECC, ask the Commission to clarify that the ERO and Regional Entities must propose specific Rules ensuring that any imposition of a penalty is subject to due process. Others, such as Northern Maine Entities, ask that the Commission, rather than the ERO and Regional Entities, prescribe the general procedures in this context.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

492. FirstEnergy comments that the ERO should develop standardized enforcement processes providing for uniformity across regions except in discrete circumstances so that a user, owner or operator of the Bulk-Power System is not subject to different enforcement procedures, fines or other sanctions simply because of geographic location.

493. APPA notes that there is currently little detail regarding the procedures that the ERO and Regional Entities will use to assess penalties and, therefore, suggests that the Commission revise the proposed regulations to provide that "the specific procedures to be used will be ordered in the context of each proceeding."

Commission Conclusion

494. The Commission agrees with the commenters that the ERO and Regional Entities must have procedures to ensure due process when considering whether to impose a penalty. We interpret section 215(c)(2)(C) of the FPA, which requires the ERO to have established Rules that, inter alia, "provide fair and impartial procedures for enforcement of reliability standards . . . .," as requiring due process in enforcement proceedings.[130] Accordingly, the Commission expects an ERO candidate to develop procedures to ensure due process and submit the procedures for Commission review with its ERO certification application.

495. Likewise, procedures to ensure due process should be included in any delegation agreement submitted for Commission review. We agree that there should be uniformity

[130] Pursuant to section 215(e)(4) of the FPA, Regional Entities must also establish fair and impartial enforcement procedures.

among the ERO and Regional Entities regarding due process elements such as adequacy of notice and opportunity to present facts and arguments at a hearing before an impartial adjudicator. These general due process requirements should be identified in the pro forma delegation agreement either explicitly or by reference to the ERO Rules.

iii. Notice

496. The NOPR proposed that the ERO or a Regional Entity must include specified information in any notice of an enforcement action.[131]

Comments

497. NiSource asks the Commission to revise the proposed regulation to clarify that both proposed sections (a)(2) and (c) of the proposed enforcement regulations refer to the same notice that the ERO must file with the Commission following a finding that an entity violated a Reliability Standard.

Commission Conclusion

498. The Final Rule adopts the substance of the proposed notice requirement with some minor changes for purposes of clarification. In response to NiSource, the Final Rule revises the text of the proposed regulations to consistently use the term "notice of penalty" when referring to the notice the ERO must file with the Commission following imposition of a penalty.

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[131] NOPR at P 59.

iv. Effective Date of Penalty and Commission Review of Penalties

499. The NOPR proposed that a penalty imposed by the ERO or a Regional Entity may take effect not earlier than the 31st day after the ERO files with the Commission a notice of penalty and the record of the proceeding.[132] Such penalty would be subject to review by the Commission, either on its own motion or upon application by the entity that is the subject of the penalty filed within 30 days after the date such notice is filed with Commission. An application to the Commission for review, or the initiation of review by the Commission on its own motion, would not operate as a stay of such penalty unless the Commission otherwise orders. In any proceeding to review a penalty, the Commission, after public notice and opportunity for hearing, would by order affirm, set aside or modify the penalty and, if appropriate, remand to the ERO for further proceedings.

(a) Effective Date and General Commission Review

500. TAPS notes language in the proposed enforcement regulations that would allow a Regional Entity to interact directly with the Commission. TAPS believes that this approach is inconsistent with sections 215(e)(1) and (2) of the FPA, which authorize the ERO to impose penalties, the ERO to file notice of a penalty with the Commission, and the Commission to remand an action to the ERO. According to TAPS, any imposition of a penalty should go through the ERO to ensure consistency and prevent the undermining

[132] Id. at P 60.

of its authority. Likewise, PG&E contends that the proposal that a Regional Entity may file a notice of penalty with the Commission to start the 30-day window for seeking Commission review precludes any meaningful opportunity to appeal to the ERO a penalty imposed by a Regional Entity. PG&E suggests that, if the Commission allows an appeal of a Regional Entity action to the ERO, the Commission should delete the language allowing a Regional Entity to file a notice with the Commission.

501. PG&E also requests that, to avoid a situation where the ERO or a Regional Entity imposes a penalty only to have the Commission reverse the decision on review, the Final Rule should modify the proposed regulation to allow for an automatic stay of a penalty once a Commission review is initiated.

502. Ameren suggests that the Commission clarify the types of further proceedings that it contemplates should it remand a penalty to the ERO.

503. The Oklahoma Commission suggests that the Final Rule include a process for a state commission, through its own concurrent jurisdictional authority, to intervene and participate in an investigation, "penalty imposition," and Commission review of a penalty (including those involving a Cybersecurity Incident) to the extent a state commission deems necessary to fulfill its ratemaking or other authorities. It notes the Commission's current rules that allow state commissions to intervene in proceedings before the Commission.

504. NERC asks the Commission to reconsider the proposed notice and opportunity for comment on a notice of penalty filed with the Commission. NERC states that the Commission does not currently allow the public to participate in enforcement

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

proceedings. Further, for purposes of clarification, NERC proposes modifying the first sentence of proposed section 38.5(d)(4) to include the phrase "[a]n applicant for review of a penalty shall file…."

Commission Conclusion

505. The Final Rule adopts, with some non-substantive changes, the proposed regulations regarding the effective date of a penalty and Commission review of a penalty. The Commission may review a penalty, but only on its own motion or upon application by the entity that is subject of the penalty.

506. We agree with the commenters who suggest that only the ERO should file with the Commission a notice of penalty. A Regional Entity that determines, after due process, to impose a penalty, must submit a notice to the ERO, which may then submit the notice of penalty to the Commission. Likewise, a Commission remand of any penalty-review proceeding pursuant to section 39.7(e)(5) is a remand to the ERO regardless of the entity that would impose the penalty. Accordingly, the Final Rule modifies the proposed regulation text at section 39.7(c) to provide that the ERO must file the notice of penalty with the Commission.

507. We reject PG&E's suggestion to modify the proposed regulation by including an automatic stay of a penalty once Commission review is initiated. Section 215(e)(2) of the FPA requires that an "application to the Commission for review, or the initiation of review by the Commission on its own motion, shall not operate as a stay of such penalty unless the Commission otherwise orders…." Our regulations at section 39.7(e)(3) provide the opportunity for a stay on a case-by-case basis (either as a result of a motion

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

by the alleged violator or an order by the Commission). We see no need to order an automatic stay in the Final Rule for review of all penalties.

508. Ameren asks for clarification regarding the types of further proceedings the Commission contemplates if a penalty is remanded to the ERO pursuant to section 39.7(e)(5). Without limiting ourselves in addressing a specific circumstance, we believe that a remand to the ERO for additional fact-finding proceedings may be appropriate. For example, we may determine that additional fact-finding is necessary regarding an alleged violation, or support for a penalty imposed, and conclude that the ERO is best situated to engage initially in such fact-finding.

509. With regard to the Oklahoma Commission's comments, we agree that a state commission generally may intervene in a Commission proceeding for review of a penalty imposed by the ERO or a Regional Entity. To address these comments, we distinguish between an investigation pursuant to Part 1b of our regulations and an adjudicatory proceeding arising out of such an investigation. Under Part 1b, the Commission and its staff treats as nonpublic any enforcement investigation and any information and documents obtained during such investigation except to the extent that the Commission directs or authorizes the public disclosure of the investigation.[133] There are no parties in a Part 1b enforcement investigation, and no person may intervene or participate as a

[133] 18 CFR 1b.9 (2005). Pursuant to this regulation, public disclosure of investigative information or documents also may occur during the course of an adjudicative proceeding or when required under the Freedom of Information Act.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

matter of right in such an investigation.[134] However, if a Part 1b enforcement investigation leads to an on-the-record proceeding in which the existence of a violation and any appropriate sanction for it are at issue, interventions in that proceeding are governed by Rule 214 of our Rules of Practice and Procedure.[135] In this respect, a proceeding in which the Commission reviews a penalty assessment by a Regional Entity or the ERO is no different from an on-the-record proceeding resulting from a Part 1b investigation or a formal complaint filed with the Commission in which a complainant alleges the existence of a violation and requests that the Commission assess a penalty for it.

510. We view inquiries conducted by the ERO or a Regional Entity into alleged violations or self-reported violations as well as ERO or a Regional Entity monitoring and enforcement audit activities to determine whether violations are occurring to be akin to our staff's Part 1b investigations. As a result, we conclude that these activities generally should be nonpublic and that there should be no right to intervene in them.

511. Moreover, we will not require that a state commission have a right to intervene in any ERO or Regional Entity investigation or imposition of a penalty. If the ERO or a

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[134] 18 CFR 1b.11. Part 1b enforcement investigations differ as a general matter from "investigations" the Commission initiates pursuant to section 206 of the FPA. Section 206 investigations are public on-the-record proceedings in which interventions may occur; Part 1b investigations generally are nonpublic and may be initiated by the Commission or its staff.

[135] 18 CFR 385.214.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entity wishes to conduct a public investigation, enforcement audit or permit interventions when determining whether to impose a penalty, the ERO or the Regional Entity must receive advance authorization from the Commission. Consistent with further discussion below, ERO or Regional Entity investigations, enforcement audits and penalty actions must be nonpublic if they involve a Cybersecurity Incident or would jeopardize Bulk-Power System security if disclosed publicly. Further, while we are allowing interventions and comments by third parties in a proceeding for review of a penalty imposed by the ERO or a Regional Entity, we expect in most instances not to open the record to additional material from third parties that was not in the record compiled by the ERO or the Regional Entity.[136]

512. However, we reject NERC's suggestion that we eliminate the notice and opportunity to comment in a Commission proceeding to review a penalty. As explained above, while our rules generally require that a Part 1b investigation be nonpublic, the Commission issues public notice of filings made with it and interventions are allowed pursuant to the requirements in Rule 214 in on-the-record adjudicatory proceedings relating to violations and penalties. Other than with respect to a Commission proceeding that relates to a Cybersecurity Incident or that would jeopardize Bulk-Power System security if made public, commenters have not provided any compelling reason that the

[136] See 16 U.S.C. 824(o)(e)(2) (providing that a hearing for Commission review of a penalty imposed by the ERO "may consist solely of the record before the ERO and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the penalty.")

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission's review of the assessment of penalties pursuant to section 215 of the FPA should differ in this respect from other, similar proceedings.

513. We clarify the first sentence of section 39.7(e)(2), based on NERC's proposal and further revised based on our concerns, to state: "An applicant filing an application for review shall comply with the requirements for filings in proceedings before the Commission."

(b) Automatic Commission Review of Certain Penalties

514. The Commission asked for comment on whether it should determine by rule that certain categories of penalties should be automatically subject to Commission review.[137]

Comments

515. Most commenters oppose this proposal, explaining that the entity against which the penalty is assessed should decide whether to appeal a penalty and, to do otherwise, would increase costs to participants and administrative burdens.[138] Similarly, NERC comments that there is no need for automatic review where there is no contest. It also notes that the Commission has the authority to review any particular case.

516. A few commenters support automatic Commission review in limited situations. ERCOT and PG&E state that a penalty above a threshold dollar amount should

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[137] NOPR at P 71 (enforcement question 5).

[138] See, e.g., AEP, Ameren, APPA, EEI, FRCC, LADWP, MRO, NERC, New York Companies, Progress Energy, SERC, SoCalEd, South Carolina E&G, TVA and WECC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

automatically trigger Commission review. PG&E states that automatic review would promote fairness and consistency among Regional Entities with regard to high penalties. NiSource proposes that a monetary penalty falling within the top 25 percent of a penalty range or guideline and a non-monetary penalty that is in effect for 60 days or longer should trigger automatic Commission review. APPA comments that the Commission may want to revisit this issue in the periodic ERO recertification proceeding.

Commission Conclusion

517. The Commission is not adopting an automatic review provision. We agree with the vast majority of commenters that there is no need for automatic review of certain penalties. The Commission retains the option to review a penalty on a case-by-case basis if an entity against which a penalty is assessed fails to appeal the penalty before the Commission.

v. Answer to an Application for Review

518. The NOPR provided that, unless the Commission orders otherwise, answers, interventions and comments to an application for review of a penalty must be filed within twenty (20) calendar days after the application is submitted.

519. APPA suggests that the Commission revise this section to require that answers, interventions and comments to an application for review of penalty be filed within twenty days of notice to the public, as opposed to the currently proposed “within twenty days after the application is filed.”

Commission Conclusion

520. We do not adopt APPA's recommendation. The NOPR's proposal, as reflected in section 39.7(e)(4) of the Final Rule, is consistent with the statute's requirement that the Commission develop expedited procedures for review of penalties. The Commission has discretion to change the deadline in specific proceedings if it determines that more time for responses is appropriate.

d. Nonpublic Matters and CyberSecurity Procedures

521. The proposed rule would establish a limited exception to the public notice requirement and allow nonpublic proceedings before the Commission for matters that involve a Cybersecurity Incident, unless the Commission determines on a case-by-case basis that such protection is not necessary.[139] The alleged violator would be given timely notice and an opportunity for a nonpublic hearing. The Commission sought comment on (1) whether the proposal provides sufficient due process and (2) the identification of other specific events that should be subject to nonpublic hearing procedures.

Comments

522. A number of commenters state that the Commission's proposal provides sufficient due process.[140] South Carolina E&G, NiSource and others comment that a

[139] NOPR at P 62.

[140] See, e.g., ERCOT, NERC, NiSource, Progress Energy, Santee Cooper and FRCC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

nonpublic hearing in which the alleged violator can be heard coupled with a right to appeal provide sufficient due process.

523. EEI and others suggest that, in addition to actions involving a Cybersecurity Incident, all other proceedings should be nonpublic if they involve an unconfirmed violation, i.e., when there has not been an admission of a violation or a determination by the ERO or a Regional Entity that a violation occurred.[141] The commenters explain that this practice is appropriate because most investigations or proceedings regarding reliability matters are likely to involve confidential or sensitive information that should be shared only with investigators. In particular, an investigation or proceeding regarding physical assets that make up the Bulk-Power System may involve sensitive information and may include critical energy infrastructure information (CEII). Further, public disclosure of an alleged violation can damage a utility's reputation and its relationship with customers and regulators and cause financial impacts. Thus, these commenters assert that a nonpublic proceeding is appropriate because an entity should not suffer any adverse consequences from an allegation that an entity violated a Reliability Standard until due process has been completed.

524. National Grid adds that EPAct, which elsewhere specifically requires "public" notice, speaks only of "notice and opportunity for hearing" in section 215, suggesting that only the alleged violator is entitled to notice.

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[141] See also Ameren, National Grid, NiSource, WestConnect and Xcel Energy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

525. Some commenters suggest that there should be no public dissemination of any information involving a Cybersecurity Incident or an incident that compromises physical security or exposes a single point of weakness of a specific user, owner or operator of the Bulk-Power System (even after a violation is confirmed) because it is possible that system security and reliability would be further jeopardized if potential vulnerabilities are publicly identified.[142]

526. Other commenters support the provision to make a Cybersecurity Incident proceeding nonpublic but do not advocate any further extension of nonpublic proceedings.[143] AEP explains that, while public disclosure of noncompliance is proper in most cases, public disclosure in the area of cybersecurity allows for easier access and intrusion by cyber terrorists and would not be in the public interest.

527. Indianapolis P&L suggests that the Final Rule allow an entity involved in the appeal process to make an independent showing that information is security sensitive. ELCON states that an event should not qualify for a nonpublic hearing unless there is compelling evidence that this would be in the public interest.

528. APPA questions whether the proposed procedures ensure due process, stating that the presumption in proceedings before the Commission should be in favor of proceeding publicly, unless the Commission determines for good cause shown that a proceeding

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[142] See, e.g., Ontario IESO, Progress Energy, Sante Cooper, SERC and TVA.

[143] See, e.g., AEP, ELCON, IPL, LADWP, Ohio Commission, PSEG Companies, Siemens, South Carolina E&G, Southern and WECC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

should be closed. Thus, while respecting national security concerns, APPA advocates handling confidentiality issues on a case-by-case basis to maintain transparency when possible. APPA believes that transparency is important because industry participants have the right to know how the Commission is applying a Reliability Standard in a particular case and transparency would foster industry confidence that the reliability regime is being fairly administered. Siemens notes that, without mandated reporting of Cybersecurity Incidents, good metrics cannot be developed to assess cybersecurity threats and countermeasures.

529. TAPS cautions that nonpublic procedures for cybersecurity enforcement are inconsistent with due process and threaten core principles, such as the right to a speedy and public trial, underlying the nation's administrative and judicial processes. According to TAPS, the public has an interest in knowing that a Cybersecurity Incident occurred at a particular facility or with the involvement of a particular contractor. TAPS states that it is not seeking public disclosure of information that endangers national security, but is concerned that an across-the-board ban on public disclosure goes too far.

530. NASUCA supports maintaining confidentiality of the details of a Cybersecurity Incident and violation, but believes that the identity of the violator and the fact that a violation occurred should be publicly disclosed. NRECA asks the Commission to explain why the CEII procedures are not adequate for cybersecurity violations. NRECA remarks that, alternatively, if CEII protections are inadequate for cybersecurity, they may be inadequate for other purposes as well and that such protections may need to be changed generally.

531. Cinergy is concerned about the need to maintain the confidentiality of commercially sensitive data during a penalty proceeding. In particular, it suggests that the Commission establish a requirement to notify third parties before their data is submitted in an action and allow any party or third party whose data is submitted in a penalty proceeding to request confidential treatment of data.

Commission Conclusion

532. Our conclusion addresses separately two related issues raised by commenters: at what stage an investigation or penalty should be nonpublic, and what types of events should receive nonpublic treatment.

i. Stage at Which an Investigation or Penalty should be Made Public

533. The Commission recognizes that it is generally desirable for investigations relating to a violation or an alleged violation to be nonpublic. As noted by commenters, public disclosure of an investigation may affect the reputation of an alleged violator, which in turn could have significant financial ramifications. Further, a nonpublic investigation would make less likely the possible public disclosure of information relating to a system vulnerability. We also note that a violator or an alleged violator is more likely to cooperate in a nonpublic investigation. As previously discussed, pursuant to section 39.7(b)(4) of the Final Rule, an investigation conducted by the ERO or a Regional Entity of a violation or an alleged violation of a Reliability Standard will be nonpublic unless the Commission authorizes a public investigation. This approach is consistent with our Part 1b rules relating to investigations that, as discussed above,

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

require nonpublic investigations except to the extent the Commission publicly discloses the existence of an investigation or investigative information.[144]

534. Accordingly, the Final Rule revises the proposed regulations to eliminate the requirement that the ERO or a Regional Entity provide "public" notice when determining whether to impose a penalty. As revised, the ERO or a Regional Entity will conduct a nonpublic investigation or penalty action unless otherwise authorized by the Commission. For example, there may be circumstances in which a public investigation may be appropriate or a particular entity may prefer the openness of a public forum. We direct any ERO applicant to submit ERO Rules with an ERO certification application, and Regional Entity Rules with a delegation agreement, that require nonpublic investigations and confidentiality of material obtained during an investigation unless otherwise authorized by the Commission.

535. Moreover, if the ERO or a Regional Entity determines that a user, owner, or operator has violated a Reliability Standard and imposes a penalty, the ERO must file a notice of penalty with the Commission pursuant to section 215(e)(1) of the FPA. The Commission will publicly disclose the filing of such a notice, except as discussed below with respect to Cybersecurity issues and other matters that would jeopardize Bulk-Power System security if publicly disclosed. Except for these issues, an application for review and also the related proceeding at the Commission will be made public. Participants in a

[144] 18 CFR Part 1b.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

public enforcement proceeding conducted at the Commission will have the opportunity to seek confidential treatment of materials and a protective order pursuant to our Rules of Practice and Procedure.

536. While recognizing the role of nonpublic investigations, we also encourage entities to disclose violations voluntarily early in the enforcement process. We believe that voluntary disclosure would benefit the public, for example, in understanding the cause of a disruption in electric service. Other industry members would benefit if they understand sooner the causes of such a disruption, how the user, owner or operator of the Bulk-Power System acted and the results of these actions.

537. Finally, regarding Cinergy's concern about protecting third-party data, third-party data may well be relevant to a determination whether to impose a penalty. However, we will not attempt to set out here a complete set of criteria for disclosure or non-disclosure. Instead, we will consider the nature and relevance of the data on a case-by-case basis.

ii. Nonpublic Treatment of Certain Types of Proceedings

538. As explained in the NOPR, and confirmed by numerous commenters, a proceeding involving a Cybersecurity Incident requires additional protection because it is possible that Bulk-Power System security and reliability would be further jeopardized by the public dissemination of information involving incidents that compromise the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

cybersecurity system of a specific user, owner or operator of the Bulk-Power System.[145] For example, even publicly identifying which entity has a system vulnerable to a "cyber attack" could jeopardize system security, allowing persons seeking to do harm to focus on a particular entity in the Bulk-Power System. While the Commission recognizes the benefit of transparency in Commission proceedings, as discussed by APPA and TAPS, the benefits of transparency are overridden in the limited situation of cases in which such transparency would jeopardize Bulk-Power System security.

539. The Commission may establish a nonpublic proceeding if public disclosure would jeopardize system security. We find that, in the balance, Commission authority to establish a nonpublic proceeding if necessary and lawful, including but not limited to, a proceeding involving a Cybersecurity Incident, serves an important public interest that outweighs the competing goals of openness and transparency.

540. Commenters identify a number of categories of incidents or types of facilities that they believe should be subject to a nonpublic hearing at the Commission. We are concerned, however, that this prescriptive approach would result in an overly inclusive requirement for nonpublic proceedings even if they are not necessary or, conversely, an overly narrow requirement that would make public a proceeding that is deserving of nonpublic treatment. Thus, section 39.7(e)(7) of the Final Rule allows the Commission to determine on a case-by-case basis whether a particular Commission proceeding to

[145] NOPR at P 62.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

review an enforcement penalty for violation of a Reliability Standard can and should be nonpublic.

e. Commission-ordered Compliance and Penalties

541. The NOPR provided that, on its own motion or upon complaint, the Commission may order compliance with a Reliability Standard and may impose a penalty against a user, owner or operator of the Bulk-Power System, if the Commission finds, after notice and opportunity for hearing, that the user, owner or operator has engaged or is about to engage in any acts or practices that constitute or will constitute a violation of a Reliability Standard.[146]

542. Related to this provision, the NOPR asked if the Commission should clarify that, in a situation where an entity is about to engage in an act that will constitute a violation of a Reliability Standard, Commission action should be in the form of a compliance order with the goal of preventing the violation from occurring; and further clarify that an entity that has engaged in an actual violation may be subject to both penalties and a compliance order.[147] The NOPR also asked whether there are situations that may warrant a penalty where an entity is about to engage in activity that would violate a Reliability Standard but the activity was ultimately averted.

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[146] NOPR at P 65.

[147] NOPR at P 71 (enforcement question 10).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Comments

543. Many commenters favor the issuance of a compliance order as the appropriate response to an entity that is about to engage in activity that would violate a Reliability Standard.[148] However, some believe that a compliance order is unnecessary, overly-prescriptive or simply adds an additional layer of bureaucracy.[149] Further, most commenters believe that, in a situation where an entity is about to engage in activity that would violate a Reliability Standard but the activity is ultimately averted, imposing a monetary penalty is not justified and raises serious due process issues.[150] A few commenters suggest that monetary penalties may be warranted in extreme situations that, for example, involve intentional acts or reckless misconduct that endanger system reliability.

Commission Conclusion

544. In section 39.7(f) of the Final Rule, the Commission adopts the proposal in the NOPR that the Commission may order compliance with a Reliability Standard and may impose a penalty on a user, owner or operator of the Bulk-Power System. We confirm that, in a situation that is brought to our attention where an entity is about to engage in an

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[148] See, e.g., Ameren, EEI, EPSA, International Transmission, NERC, NRECA, NYISO, Progress Energy, South Carolina E&G and Southern.

[149] See, e.g., Cinergy and Portland GE.

[150] See, e.g., AEP, Ameren, EEI, ERCOT, Kansas City P&L, NERC, New York Companies, Santee Cooper, SERC, SoCalEd, South Carolina E&G, Southern and TVA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

act that would constitute a violation of a Reliability Standard, our action would typically be in the form of a compliance order. If an entity fails to comply with the compliance order, we could seek enforcement through an action for injunctive relief in the appropriate court.

545. We believe that, in most circumstances, a monetary penalty would not be appropriate where a violation is imminent but ultimately averted.[151] Nonetheless, we will not limit our options in responding to an extraordinary circumstance. The Commission does not state as a matter of policy that it will never impose a monetary penalty in a situation where an entity is about to violate a Reliability Standard. Likewise, we will not limit our options with regard to imposing an appropriate non-monetary penalty where an entity is about to engage in an action that would violate a Reliability Standard but the activity is ultimately averted.

546. The Final Rule does not preclude the ERO or a Regional Entity that is aware of an entity that is about to engage in an act or practice that would result in noncompliance from notifying the entity by issuing a compliance directive. If, after receiving such a directive, the entity does not take appropriate action to avert a violation of a Reliability Standard, the ERO or Regional Entity could file a petition with the Commission to issue a Commission compliance order. The Commission would review such a petition on an expedited basis. Alternatively, if the ERO or a Regional Entity determines that an

[151] See section 215(e)(3) of the FPA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

entity's imminent action or inaction could jeopardize Bulk-Power System reliability, the ERO or Regional Entity may seek immediate injunctive relief in an appropriate court.

f. Penalties' Relation to the Seriousness of the Violation

547. The NOPR provided that any penalty imposed for the violation of a Reliability Standard shall bear a reasonable relation to the seriousness of the violation and shall take into consideration efforts of such user, owner or operator of the Bulk-Power System to remedy the violation in a timely manner.[152] The proposal stated that penalties should not be limited to monetary penalties and may include limitations on activities, functions, operations, or other appropriate sanctions, including the establishment of a reliability watch list composed of major or frequent violators.

Comments

548. International Transmission and Michigan Electric ask for clarification that the phrase "seriousness of the violation" is intended to correlate the magnitude of the penalty with the actual or potential impact of a violation.

549. EPSA asks for clarification on whether the phrase "limitations on activities, functions [or] operations," is intended to bar users, owners or operators from engaging in transactions or operating their facilities for an indefinite period of time. EPSA states that, while suspension of operations may be necessary to address immediate reliability concerns, suspension could also adversely affect reliability. Also, if a limitation on

[152] NOPR at P 76.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

activity is intended to deprive the violator of the fruits of its violation, EPSA contends that a monetary penalty should provide a sufficient sanction.

550. Ameren seeks clarification of the term "major violators" that may be placed on a reliability watch list.

Commission Conclusion

551. Section 39.7(g) of the Final Rule adopts the NOPR proposal that a penalty must bear a reasonable relation to the seriousness of the violation. While the actual or potential effect of a violation is certainly one consideration in determining the seriousness of the violation, it is not the only consideration, in contrast to the suggestions of International Transmission and Michigan Electric. For example, a violation by an entity with a weak compliance program may merit a larger penalty than a violation by an entity with a strong compliance program.[153] All users, owners and operators of the Bulk-Power System should have in place strong programs to ensure compliance with ERO and Regional Entity Reliability Standards.

552. With regard to EPSA's request for clarification, a non-monetary penalty involving a limitation on activities, functions or operations may include, but is not limited to, a ban on engaging in certain transactions or limiting the operation of facilities. The duration of the ban would normally be for the period needed to implement the necessary

[153] Enforcement of Statutes, Orders, Rules, and Regulations, 113 FERC ¶ 61,068 at P 22-23 (2005) (identifying internal compliance as a factor the Commission will take into account when determining a civil penalty).

corrective action, whether installation of required equipment or completion of personnel training.

553. Regarding Ameren's request for clarification of the term "major violators" that may be placed on a reliability watch list, we clarify that the term includes users, owners or operators that have either committed one or more serious violations or have a history of frequent, albeit less serious violations.

i. Penalty Guidelines

554. The Commission asked in the NOPR whether it should approve a penalty range or guidelines before the ERO can levy a penalty or sanction for any violation, and, if so, whether the penalty range or guidelines for a violation should be submitted for Commission approval at the same time that the corresponding Reliability Standard is submitted to the Commission for approval.[154]

Comments

555. Virtually all commenters on this issue agree that the Commission should approve a penalty range or guidelines that include a schedule of non-monetary and monetary penalties of increasing severity.[155] They contend that basic due process

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[154] NOPR at P 71 (enforcement question 2).

[155] See, e.g., APPA, EEI, ERCOT, FirstEnergy, FRCC, Hydro One, Kansas City P&L, LADWP, Michigan Electric, MRO, New York Companies, NEPOOL Participants, NERC, NiSource, NRECA, Ohio Commission, Ontario IESO, PacifiCorp, PSNM-TNPC, Southern, and Xcel Energy. Conversely, commenters consistently oppose a single penalty approach in response to the NOPR's question on uniform penalties, NOPR at P 71 (enforcement question 3).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

requires that a regulated entity must know both the legal standard to which its action must conform as well as the corresponding penalty before that entity can be penalized for noncompliance. Commenters, however, differ on whether the ERO should develop and submit penalty guidelines concurrent with or separate from the Reliability Standard development process.

556. Numerous commenters suggest that the Reliability Standard development process should not require that each Reliability Standard have its own range or guidelines for penalties.[156] Rather, these commenters assert that the ERO should develop, for Commission review, an enforcement policy that separates approval of penalty guidelines from approval of each Reliability Standard. These commenters suggest that, at the time a Reliability Standard is filed with the Commission for approval, the ERO should indicate what part of the overall sanctioning guidelines and penalty ranges would apply to the particular Reliability Standard. While some commenters urge uniformity and suggest that Regional Entity delegation agreements include a provision requiring use of the ERO penalty guidelines, TANC suggests that, to reflect unique regional conditions, each Regional Entity should develop its own proposal for penalty guidelines to be submitted to the ERO. PacifiCorp comments that penalty guidelines should be developed jointly by the ERO and Regional Entities to provide a balance of uniformity and regional

[156] See, e.g., AEP, APPA, TVA, EEI, FRCC, Michigan Electric, NERC, Progress Energy, Santee Cooper, South Carolina E&G, SERC and Xcel Energy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

experience. It also suggests periodic review of guidelines to ensure that the program is having the desired effect, with an opportunity for needed adjustments.

557. Other commenters support a set range of monetary and non-monetary penalties for each Reliability Standard that is submitted to the Commission for approval at the same time as the Reliability Standard is submitted.[157] These commenters assert that, to ensure that a penalty bears a reasonable relation to the violation, the penalty guideline must be not be arbitrarily developed in isolation from the development of the Reliability Standard.

558. WECC and Entergy ask that the Commission not mandate any particular approach to penalties but, rather, allow the ERO and each Regional Entity to propose standardized penalties or penalty guidelines as part of its enforcement program. SoCalEd suggests that WECC's Reliability Management System (RMS) could serve as model for establishing a graduated schedule of non-monetary and monetary penalties.

559. South Carolina E&G comments that penalties should not be imposed on an entity for failure to meet standards that are contrary to or are in violation of local, state or federal statutes or jurisdictional requirements.

560. APPA comments that the Commission should afford the ERO and Regional Entities latitude to impose higher monetary penalties on violations by larger entities than by smaller entities. For example, according to APPA, the ERO may impose a higher monetary penalty on a regional coordinator or large balancing authority responsible for

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[157] See, e.g., Ameren, American Transmission, British Columbia, Cinergy, FirstEnergy, MRO, NEPOOL Participants, NiSource, PG&E and SMUD.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

operation of a large portion of an Interconnection than a smaller balancing authority or transmission owner.

Commission Conclusion

561. The Commission concludes that penalty guidelines, developed by the ERO and approved by the Commission, would provide a predictable, uniform and rational approach to the imposition of penalties.[158] Such guidelines would help ensure that a penalty bears a reasonable relation to the seriousness of the violation, as required by section 215(e)(6) of the FPA. Accordingly, the Final Rule revises the proposed regulation text to create a new section 39.7(g)(2) that requires the ERO to develop, and submit to the Commission for approval, penalty guidelines that identify a range of non-monetary and monetary penalties to be applied by the ERO or a Regional Entity for determining the appropriate penalty for the violation of a Reliability Standard. We agree with the commenters that urge consistency in the imposition of penalties by the ERO and Regional Entities. Accordingly, Regional Entities should adopt the ERO's penalty guidelines, with changes or supplements only as necessary to reflect regional differences

[158] Our Policy Statement on Enforcement articulates factors the Commission considers when determining an appropriate penalty. See Enforcement of Statutes, Orders, Rules, and Regulations, 113 FERC ¶ 61,068. The ERO should look to our Policy Statement on Enforcement for guidance in developing certain enforcement penalty policies. For example, our policies on internal compliance, self-reporting and cooperation, id. at P 22-27, may assist the ERO in formulating its enforcement penalty policies.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

in a Reliability Standard. Any such changes by a Regional Entity must be approved by the ERO and the ERO must submit them to the Commission for approval.

562. The ERO may propose for Commission review one set of penalty guidelines for all Reliability Standards, with the flexibility to propose a unique penalty for a particular Reliability Standard, if necessary. The Commission must approve the proposed penalty guidelines prior to the ERO's use of the guidelines to impose a penalty for the violation of a Reliability Standard.

563. With regard to South Carolina E&G's comment, we do not preclude the imposition of a penalty if an entity is in noncompliance with a Reliability Standard that is inconsistent with a state or local statute or regulation. We also note that South Carolina E&G has not provided any examples of when such a conflict would exist and we would expect any such conflicts to be rare. In our December 9, 2005 technical conference, the state representatives testified that standards or regulations adopted at the state level are complementary to, or more stringent than, continent-wide or regional Reliability Standards, not less stringent or in conflict with them.[159]

564. We agree with APPA that the relative size of an entity or its financial ability is a factor that the ERO or a Regional Entity may consider when developing penalty guidelines or determining an appropriate penalty in a particular case.

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[159] December 9, 2005 Technical Conference, Tr. at 95.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

ii. Non-Monetary Penalties

565. The NOPR requested comments regarding what types of non-monetary penalties, if any, are appropriate.[160]

Comments

566. Most commenters suggest that non-monetary penalties are appropriate and that such sanctions may include: imposing a limit on activities, functions and operations; turning over operation of a facility to a third party; prohibiting an entity from engaging in a certain type of transaction; requiring an entity to carry additional operating reserves for a certain period of time; increasing training requirements; and a disconnection order for persistent violators.[161]

567. While some commenters recommend suspending or revoking appropriate organizational certification,[162] PG&E believes that this sanction may be appropriate for other industries regulated by a self-regulatory organization, but is inappropriate in the utility industry.

568. SMUD suggests that the ERO have flexibility in imposing non-monetary penalties, so long as the penalty is proportionate to the violation and is tied to the nature of the conduct to be discouraged. APPA notes that section 215(e)(6) of the FPA requires

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[160] NOPR at P 71 (enforcement question 6).

[161] See, e.g., EEI, ERCOT, Hydro-Québec, Kansas City P&L, NERC, New York Companies, and Ontario IESO.

[162] See, e.g., Ameren, International Transmission, MRO and WECC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

that any penalty must bear a reasonable relationship to the seriousness of the violation and take into consideration timely remedial efforts.

569. Progress and SERC suggest that, generally, Regional Entities should administer non-monetary penalties, which should apply to "administrative" violations such as failure to produce documentation required by a Reliability Standard. In contrast, Alcoa comments that only the Commission should impose non-monetary penalties.

Commission Conclusion

570. Section 215 of the FPA contemplates the imposition of both non-monetary and monetary penalties. Section 215(c)(2)(C) of the FPA provides that the ERO certified by the Commission must have ERO Rules that, inter alia, provide fair and impartial procedures for enforcement of Reliability Standards "including limitations on activities, functions, or operations, or other appropriate sanctions."

571. While commenters identify an array of possible non-monetary penalties, the Commission is not formally adopting or rejecting any particular suggestion here. The appropriate penalty for a particular violation should be determined on a case-by-case basis, based on the circumstances and consistent with the penalty guidelines proposed by the ERO and approved by the Commission pursuant to section 39.7(g)(2) of the Final Rule. These guidelines should include monetary and non-monetary penalties.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

iii. Limits on Monetary Penalties

572. In the NOPR, the Commission interpreted section 316A of the FPA,[163] as amended by EPAct, as establishing a limit on a monetary penalty for a violation of a Reliability Standard that may be imposed by the ERO, Regional Entities and the Commission.[164] The Commission asked for comment on this interpretation.

Comments

573. Most commenters agree that the $1 million per day, per violation cap set forth in section 316A of the FPA applies to any FPA-related violation, whether the monetary penalty is levied by the Commission, the ERO, or a Regional Entity.[165] TAPS states that, although it is not clear whether the statutory cap applies to the ERO, the Commission would be prudent to apply the cap to all monetary penalties, while reserving for future judgment the question of the ERO's authority to exceed the $1 million/day limit if it is insufficient to deter violations.

574. Some comment that, in addition to the statutory cap, the ERO should develop, for regulatory approval, a limit on the monetary penalty for violation of a particular Reliability Standard. NERC suggests that such a limit should balance two factors: (1) that a penalty should not negatively affect the ability of an entity to maintain

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[163] 16 U.S.C. 825o-1.

[164] NOPR at P 71 (enforcement question 4).

[165] See, e.g., AEP, Alcoa, Ameren, APPA, EEI, FRCC, MISO Transmission Owners, MRO, NERC, NRECA, PG&E, Progress Energy and Xcel Energy.

reliability and (2) that a penalty must be sufficient to assure that the entity responsible to maintain reliability does not make an economic choice to violate a Reliability Standard. Ameren comments that such a limit would benefit consumers because the risk of an open-ended penalty would be passed to consumers in the form of higher costs.

Commission Conclusion

575. The Commission confirms its interpretation that section 316A of the FPA establishes a limit on a monetary penalty for a violation of a Reliability Standard that may be imposed by the Commission, the ERO, or a Regional Entity pursuant to FPA section 215. The ERO, when developing penalty guidelines, may propose an appropriate range of monetary penalties for violation of each Reliability Standard that is up to the cap for general civil penalties under Part II of the FPA in light of factors relating to a particular Reliability Standard. The ERO's penalty guidelines, including any limits, will be subject to Commission approval.

g. Reporting Violations and Alleged Violations

i. Procedures for Reporting Violations and Alleged Violations

576. The NOPR proposed that the ERO and all Regional Entities must have procedures to notify the Commission of all violations and alleged violations of Reliability Standards concurrent with the time that the ERO or Regional Entity first notifies the user, owner or operator of the violation or alleged violation.[166]

[166] NOPR at P 71 (enforcement question 11).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Comments

577. NiSource asks the Commission to clarify the meaning of "potential violation." EPSA and the Oklahoma Commission suggest that any entity identified as having allegedly violated a Reliability Standard be notified immediately of any enforcement investigation.

578. Cinergy comments that it is possible that a violation may relate to improper documentation or a missed reporting deadline set forth in a Reliability Standard. Thus, in reporting a violation or alleged violation to the Commission, a significant incident of noncompliance worthy of Commission attention may get "lost in the shuffle." Cinergy, therefore, recommends that the Commission either require reporting only of those violations that have a material impact on reliability or classify the violations and have less urgent violations reported in a quarterly report.

579. NiSource asks the Commission to clarify that the ERO and Regional Entities must report to the Commission when an enforcement proceeding is closed without a penalty to "clear" the record on the alleged violation.

580. Several state commissions ask that affected state commissions receive notice of a violation or alleged violation simultaneously with the Commission.[167] The Missouri Commission adds that a state commission should receive access to confidential

[167] See, e.g., Missouri Commission, North Carolina Commission, Ohio Commission and Oklahoma Commission.

information relating to a reliability event affecting its state or an entity serving load in its state.

Commission Conclusion

581. The Commission adopts the substance of the proposed reporting requirement in section 39.7(b) of the Final Rule. Several commenters request clarification of the proposed reporting requirement. First, the NOPR referred to a "potential violation." This term creates an ambiguity between an alleged past violation and future action that would be a violation. The Final Rule uses the term "alleged violation" in its place.

582. Further, as explained earlier in the discussion of due process issues, an entity alleged to have violated a Reliability Standard is entitled to timely notice of any such allegation. The regulation, however, does not specify a time for the ERO or a Regional Entity to provide such notice. Rather, the proposed provision required that the ERO or Regional Entity report a violation or alleged violation to the Commission concurrent with the alleged violator receiving notice. Consistent with our view of the ERO's lead role in the enforcement process, we amend this provision to provide that the ERO must promptly notify the Commission of a self-reported violation or an investigation into a violation or alleged violation.

583. This notification provision is intended as a mechanism to provide the Commission promptly with limited information, as described in the proposed regulation, to enable the Commission to understand the general nature of a violation or an alleged violation and identify a contact person who can furnish its status to the Commission. The Commission requires prompt information regarding all violations and alleged violations

of a Reliability Standard, not the delayed notification proposed by Cinergy. The requirement is to report both "violations" and "alleged violations."

584. We reject Cinergy's suggestion that the Commission either require only the reporting of violations that have a material impact on reliability or classify violations and allow the reporting of "less urgent" violations on a quarterly basis. While we recognize that violations of Reliability Standards may vary in degree of immediate impact on system reliability, classifying violations as "less urgent" is ultimately subjective. Thus, for example, a seeming "less urgent" violation that is significant in the context of a specific occurrence may not be reported if we were to adopt Cinergy's proposal. Classifying some violations as less significant would also send the wrong signal to users, owner and operators of the Bulk-Power System. If experience proves the proposed reporting system to be inefficient or unnecessary, we can revisit this matter in the future.

585. With regard to NiSource's request for clarification, we agree that the ERO and Regional Entities should report to the Commission the disposition of each violation or alleged violation. Accordingly, section 39.7(b) of the Final Rule requires that, after the ERO submits a report of a violation or alleged violation, it must subsequently inform the Commission of the disposition of the matter. The ERO applicant should propose a process for periodically reporting to the Commission the disposition of violations and alleged violations on a quarterly basis.

586. As discussed above, a state commission generally will have an opportunity to intervene in an adjudicatory proceeding before the Commission, including a Commission review of a penalty imposed by the ERO or a Regional Entity. Further, we will require

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the ERO and Regional Entities to notify a Regional Entity and Regional Advisory Body of all violations that have been determined to have occurred within its region at the conclusion of the appeals process. However, we are not requiring here that a state commission receive notice of an alleged violation of a Reliability Standard or receive access to confidential information when the ERO or a Regional Entity considers whether to impose a penalty. As discussed below, the Commission will treat a report of an alleged violation as nonpublic information, and a general rule providing a state commission access to nonpublic information would be contrary to the Commission's rules for treatment of investigative information.

587. The NOPR proposed, in the provisions on Reliability Reports, a requirement that the ERO and Regional Entities must report on their enforcement actions and associated penalties to the Commission and others. The Final Rule adopts this proposal with modifications in the section on Enforcement of Reliability Standards as new subsection 39.7(b)(5). The modifications make clear that the ERO is to report, and the Regional Entities are to report through the ERO, on violations of Reliability Standards and summary analyses of such violations as the Commission will from time to time direct, and limit this reporting to the Commission.

ii. Confidentiality of Reports

588. The NOPR, referring specifically to the proposed reporting of violations and potential, i.e. alleged, violations, asked for comment regarding what confidentiality protections may be needed.[168]

Comments

589. Numerous commenters urge the Commission to take adequate steps to ensure that the notification of an alleged violation is made to the Commission in a nonpublic manner and that the nonpublic nature of the notification is maintained until the appeals process is exhausted.[169] Some propose that, to achieve this, the Commission revise the proposed regulations by eliminating the requirement that the ERO and Regional Entities notify the Commission of an alleged violation.[170] Others propose that the Commission modify the Final Rule to state that information submitted to the Commission regarding an alleged violation must be kept confidential until the violation is "confirmed," meaning until the appeals process has been completed.[171] These commenters posit that an alleged violation that is found not to be an actual violation through the appeals process should not be disclosed to the public.

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[168] NOPR at P 71 (enforcement question 11).

[169] See, e.g., Allegheny, APPA, EEI, ERCOT, MRO, National Grid, NERC, NiSource, Progress Energy, PSEG Companies, SERC, SoCalEd, TVA and Xcel Energy.

[170] See, e.g., AEP, Entergy, NERC, Progress Energy, Santee Cooper and SERC.

[171] See e.g., APPA, EEI, Kansas City P&L, LADWP, TVA and WECC.

590. NERC explains that the disclosure of a potential violation with the alleged violator's identity could have significant and possibly irreversible negative impacts for the entity, even if it is ultimately found to have been in compliance. Further, faced with such disclosure, entities may be unwilling to cooperate with ERO and Regional Entity investigators. NERC states that a potential violation should be reported to the Commission only if the Commission ensures that the report will remain nonpublic to protect the identity of the entity involved until due process is complete. NERC asserts that a violation relating to information designated as CEII must remain confidential even when a violation is confirmed.

591. NERC adds that, if the Commission requires the reporting of potential violations, the rules should define a "potential violation" as occurring "when the ERO or Regional Entity has performed a preliminary investigation and is prepared to formally charge an entity with a violation of a Reliability Standard." NERC notes that this would add an additional stage to the compliance process, establishing a formal "charging" process.

592. South Carolina E&G states that confidentiality provisions similar to those in Part 1b of the Commission's regulations are needed to assure no unnecessary public disclosure of an enforcement investigation. Alcoa, ELCON and others state that protections similar to that afforded other Commission investigations are appropriate for reliability-related investigations. ELCON comments that a claim of confidentiality should not be used to hide a business practice that harms reliability or competition.

593. EEI opposes public disclosure unless and until a violation is confirmed. It states that, consistent with the procedures of other self-regulatory organizations, it supports an

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

approach in which the ERO immediately notifies the Commission that a compliance investigation has commenced (including the entities involved and general nature of the alleged violation), while deferring the submission of a detailed report until the investigation is completed. EEI is concerned that alternative approaches may have a chilling effect on the reporting of compliance information and the self-reporting of violations.

594. Others, such as FRCC and New York Companies, advocate that the identity of an entity subject to an investigation should be kept confidential during a proceeding below the Commission level. The commenters posit that a Commission proceeding, however, should be conducted on the basis of a public record, with suitable protections, e.g., for confidential, proprietary or critical infrastructure information.

595. TAPS states that confidentiality should be required for alleged violations, but confirmed violations should be made public, in accordance with NERC's Guidelines for Reporting and Disclosure and the Bilateral Principles. Apparently defining "confirmed violation" at an earlier stage than the final appeal, TAPS would require public notice of violations contested at the ERO level. Similarly, NASUCA comments that a confirmed violation, regardless of the severity, should be publicly disclosed--including a report to the relevant state regulatory authorities--immediately upon the finding of a violation by the ERO or a Regional Entity.

Commission Conclusion

596. The Commission finds that a report of an alleged violation pursuant to section 39.7(b) should receive nonpublic treatment. As noted by commenters, and similar to our

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

reasoning above with respect to a nonpublic investigation by the ERO or a Regional Entity, public disclosure that the ERO or a Regional Entity is investigating an entity's violation or alleged violation of a Reliability Standard could cause unwarranted damage to the entity's reputation, with resulting financial repercussion. Further, public disclosure of an investigation into a violation or an alleged violation could chill an entity's cooperation with the investigator. The Commission will not make such information public unless the Commission decides to initiate a public investigation, issue a public compliance order or initiate a public proceeding to impose a penalty, or is required by statute or regulation, as in the situation where the Commission or a court determines that information must be provided pursuant to a request for information pursuant to the Freedom of Information Act (FOIA).[172]

597. We reject the suggestions that the Commission eliminate the proposed reporting requirement altogether or have the ERO create a "formal charging" process. The nonpublic treatment of such reports should ensure that an inquiry will remain nonpublic and the subject of the inquiry will not be damaged. Accordingly, the Final Rule inserts section 39.7(b)(4) that states how an ERO report of an alleged violation will receive nonpublic treatment by the Commission.

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[172] 5 U.S.C. 552 (2000). We note that FOIA does not require the public disclosure of records or information compiled for law enforcement purposes if, for example, disclosure could reasonably be expected to interfere with enforcement proceedings, would deprive a person of a right to a fair trial or an impartial adjudication or could reasonably be expected to constitute an unwarranted invasion of personal privacy. See 5 U.S.C. 552(b)(7).

598. However, a violation determined, for example, by a finding of the ERO or a Regional Entity, self-reporting or an admission in a settlement, generally will be made public after the matter is filed with the Commission as a notice of penalty or resolved by an admission that the user, owner, or operator of the Bulk-Power System violated a Reliability Standard or a settlement or other negotiated disposition. Further, pursuant to section 39.7(b)(4) of the Final Rule, the ERO should file, for informational purposes only, any settlement of an alleged violation regardless of whether the agreement contains an admission by the settling user, owner or operator. Settlements will be made public. This is consistent with our own procedures in which enforcement settlements are made public. Settlements will not be noticed for public comment; nor will they be subject to Commission review pursuant to section 39.7(e) regarding Commission review of a notice of penalty.

599. Further, the Final Rule deletes from the proposed regulations the requirement that reports of violations and alleged violations be filed electronically with the Commission. The Commission will review the reporting procedures proposed by the ERO and Regional Entities before determining the appropriate filing procedures at the Commission.

h. Other Enforcement Issues

i. ERO and Regional Entity Appeals Processes

600. The NOPR asked for comments on the appropriate appeals process, if any, of an ERO or Regional Entity decision to impose a penalty, whether it would be appropriate for the ERO and Regional Entities to adopt processes similar to self-regulatory organizations,

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

and whether internal appeals within the ERO or a Regional Entity should be permitted before appeal to the Commission.[173]

Comments

601. A number of commenters agree that various self-regulatory organization models provide an appropriate basis for an appeals process.[174] However, commenters vary regarding the proper number of appeals and who should hear such appeals. Commenters consistently emphasize the need for fair, independent, non-discriminatory and well-defined due process procedures for appeals.[175]

602. Some commenters advocate, for a penalty imposed by a Regional Entity, a first appeal within the relevant Regional Entity, with additional appeals to the ERO and the Commission or other appropriate authority in Canada or Mexico; [176] and for a penalty imposed by the ERO, a first appeal within the ERO.[177] TAPS notes that a first appeal within the Regional Entity would allow review by those with the most knowledge about the regional system, and a further opportunity for appeal to the ERO would ensure

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[173] NOPR at P 71 (enforcement question 1).

[174] See, e.g., EPSA, FRCC, NERC, NiSource and SoCalEd.

[175] See, e.g., Alcoa, EEI, EPSA, MISO Transmission Owners, NERC and PacifiCorp.

[176] See, e.g., Ameren, American Transmission, British Columbia, ERCOT, Entergy, Hydro-Québec, MRO, NERC, Southern, TAPS and Xcel.

[177] See, e.g., American Transmission, ERCOT, Michigan Electric, NERC and Southern.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

consistency of interpretation and enforcement of ERO Reliability Standards. Entergy believes this process would help to ensure resolution of penalties before they reach the Commission, strengthen the ERO's role, and develop a clear factual record if Commission review is necessary.

603. MRO believes that the ERO working with the Regional Entities should decide on an appropriate appeals process at the ERO level. MRO and AEP advocate that the ERO, through delegation agreements, establish consistent principles for the investigations and imposition of penalties of all Regional Entities. MRO supports appeals at both the Regional Entity and ERO levels, but asks that the enforcement process not become an endless series of appeals.

604. TVA and others comment that, for non-monetary penalties imposed by a Regional Entity, neither the ERO nor the Commission should participate in the appeals process. Ontario IESO suggests that a penalty imposed by either a Regional Entity or the ERO should be appealed to the ERO, with a further appeal to the Commission or appropriate Canadian authority.[178] Ontario IESO states that ERO appellate review is essential to ensure consistency within and across regions and to reflect industry consensus.

605. CREPC comments that an appeal of a penalty imposed by an Interconnection-wide Regional Entity should be made directly to the Commission or the appropriate

[178] See also APPA, Kansas City P&L, LADWP and Michigan Electric.

Canadian authority and not "filtered" through the ERO. WECC comments that, if the Commission allows an appeal at the ERO level, such review should be subject to a rebuttable presumption of validity of the Regional Entity's findings.

606. Emphasizing that the appeals process should minimize duplicative proceedings that add costs and delay, the MISO Transmission Owners propose that the Commission create a limited, informal process at the ERO and Regional Entity levels to aid in the development of the record that is submitted to the Commission. Further, the process should allow parties to go directly to the Commission and designate the Commission as the decisionmaker. Likewise, the ISO/RTO Council and Northern Maine Entities support a direct appeal to the Commission once the ERO or Regional Entity issues a decision.

607. A number of commenters discuss various details of how appeals should be conducted. For example, FRCC comments that, while appeals should be heard by "disinterested parties," such parties must have relevant experience and expertise. Further, FRCC states that, given the importance of compliance with Reliability Standards, an appeal to the Regional Entity or ERO should not act as a stay on the effectiveness of a penalty. EEI and FRCC suggest that Regional Entities should make provision for alternative dispute resolution. Alcoa, NRECA and LADWP comment that appeals to the Commission should be reviewed de novo, with full due process and ultimately judicial review.

608. International Transmission and Michigan Electric believe that some level of review at the ERO/Regional Entity level is appropriate, and that any such appeal process should be completed in an efficient and timely manner. Further, the ERO should be

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

required to propose a specific process and timeline in its application for certification. PSEG Companies believes that the ERO and Regional Entities, through stakeholder processes, should determine the best approach to appeals and file the consensus position and the record with the Commission. Ameren believes that the Final Rule should require an expedited response period for the ERO and Regional Entities to respond to an appeal.

609. BCTC supports internal appeals at both the Regional Entity and ERO level, believing that resolving matters before an appeal to a regulatory body is more efficient. Further, given the international nature of the ERO and some Regional Entities, resolution at the ERO or Regional Entity level could provide more consistency in decisions. The Nova Scotia Board comments that appeals affecting Canadian entities would ultimately be appealed to the applicable Canadian authority. MRO states that, for actions taken against Canadian entities, the ERO could file a notice with the Commission for informational purposes.

Commission Conclusion

610. The Commission finds that an appeals process at the ERO or Regional Entity level is appropriate.[179] Such an internal appeal will assist in ensuring internal consistency in the imposition of penalties by the ERO or the Regional Entity.

611. However, the Commission shares the concern of MRO and other commenters that having both an ERO and a Regional Entity appeals process for a penalty imposed by

[179] NOPR at P 70.

a Regional Entity could result in a drawn-out series of sequential appeals. An overall process that allows for multiple appeals could result in duplication that would delay a final decision and unnecessarily increase the costs of those involved in a penalty action. Thus, we find that there should be a single appeal at either the ERO or the Regional Entity. The ERO applicant must propose in its application for certification for approval by the Commission whether the appeal of a penalty imposed by a Regional Entity should be at the ERO or Regional Entity level. An entity that is the subject of a penalty may not elect to bypass the appeals process established by the ERO and seek immediate Commission review without the approval of the ERO.

612. We agree with the commenters regarding the need for fair, independent, non-discriminatory and well-defined procedures for appeals. Such procedures are consistent with the statutory requirements that the ERO and Regional Entities have fair and impartial procedures for enforcement of Reliability Standards.[180] However, rather than the Commission prescribing the internal appeals procedures, we will allow an ERO applicant to develop procedures and submit them to the Commission for approval with an ERO certification application.

613. As discussed earlier, regardless of whether the single appeal is at the ERO or the Regional Entity level, the ERO is responsible for filing a notice of penalty with the Commission. Thus, we reject the suggestion that an appeal of a penalty imposed by a

[180] See sections 215(c)(2)(C) and (e)(4)(B) of the FPA.

Regional Entity organized on an Interconnection-wide basis should be filed directly with the Commission, bypassing the ERO.

614. With regard to the comment of Alcoa and LADWP, we agree that Commission review of a penalty imposed by the ERO or a Regional Entity would be de novo. This standard is consistent with the practice of the review by other regulatory agencies of sanctions imposed by their associated self-regulatory organizations.[181]

ii. Receipt and Use of Penalty Money

615. The NOPR asked for comments regarding who should receive, and what should be done with monies collected as monetary penalties.[182]

Comments

616. Most commenters believe that the ERO and Regional Entities should be able to make use of penalty monies. They differ, however, on how the ERO or a Regional Entity should use the money. Many suggest penalty monies be used to defray the cost of enforcement programs. Others believe it is more appropriate to apply the monies against the ERO's or Regional Entity's general operating budget. A few commenters prefer that

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[181] For example, the Securities and Exchange Commission conducts de novo review of sanctions imposed by its SRO, the NASD: "[a]ny final disciplinary sanction imposed by the [NASD] is subject to full and independent review by the Securities and Exchange Commission as to the facts as well as the law." Otto v. SEC, 253 F.3d 960, 964 (7th Cir. 2001), cert. denied, 534 U.S. 1021 (2001).

[182] NOPR at P 71 (enforcement question 7).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

penalty monies not be used by the ERO or Regional Entities but, rather, sent to the U.S. Treasury or relevant Canadian authority.

617. NERC comments that the ERO should receive all monies collected as monetary penalties for violations of ERO Reliability Standards in the United States. Under NERC's proposal, the ERO would first use the revenues to cover the incremental costs incurred by the ERO and Regional Entities in investigating a specific violation or alleged violation, including the costs of monitoring and verifying corrective actions and determining that the violation is satisfactorily resolved. According to NERC, the ERO should be authorized to disburse penalty monies to a Regional Entity that incurs an incremental cost associated with the particular violation. NERC suggests that any money remaining after such disbursements should be returned to the general operating fund of the ERO for the current year and noted as additional surplus at the year-end true up with the ERO budget. If a Reliability Standard is applicable only within a region, such as an Interconnection-wide standard, the Regional Entity should collect the penalty monies directly using procedures similar to those of the ERO.[183]

618. Many commenters[184] state that using the monies in this manner would not present a conflict of interest, noting that the Commission and other regulatory authorities would

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[183] AEP, EEI, EPSA, FRCC, MRO, Ohio Commission, Progress Energy, SMUD and TAPS also support the use of penalty monies to defray the costs of the ERO and Regional Entity enforcement programs.

[184] See, e.g., NERC, FRCC, TAPS, SERC and SoCalEd.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

have an annual review of the use of such monies and that, by including a true-up each year, the ERO would not benefit financially from the imposition of monetary penalties. FRCC further notes that the Commission would have the opportunity to approve any proposed penalty guidelines and any penalty actually imposed.

619. TAPS notes that crediting penalty monies to reduce costs borne by those in compliance is consistent with Commission precedent.[185] According to SERC, such use of penalty monies would not create an appearance of impropriety if compliance and audit programs are "sufficiently independent" and the compliance process includes a robust appeals process. SoCalEd comments that such use of penalty monies to fund enforcement programs would not create an appearance of impropriety provided that stakeholders play a role in developing both the Reliability Standards and associated penalties. SoCalEd states that such a process was used in developing WECC's Reliability Management System and has resulted in the non-subjective application of penalties for violations. Santee Cooper adds that, to avoid an appearance of impropriety, penalty monies collected by the ERO should be redistributed among all Regional Entities.

620. APPA suggests that monetary penalties should be credited on a net energy for load basis against the ERO's annual budget. While such revenues could be used to defray the cost of enforcement activities, some APPA members are concerned that penalty amounts may be set to raise sufficient revenues to offset the costs of the ERO's or

[185] Citing, e.g., Carolina Power & Light Co., 103 FERC ¶ 61,209 at P 25 (2002).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entities' enforcement programs. APPA states that, if the Commission allows the use of penalty monies to defray the cost of enforcement programs, the Commission should take steps to ensure that penalty amounts are not based on revenue needs.

621. In contrast, a number of commenters[186] assert that penalty monies should not be used to support ERO or Regional Entity enforcement activities. Some express concern that this could result in the use of enforcement activities for revenue production.[187] NEPOOL Participants believe that penalty monies should be used to reduce ERO and Regional Entity costs that would otherwise be passed on to end use customers.[188]

622. TVA states that the ERO and Regional Entities should have discretion in determining the allocation and use of penalty monies. It suggests that penalty monies be used to create reliability-related educational and training programs. ERCOT suggests that penalty monies be used to fund research, for example, to develop better operating and analysis tools for the industry.

623. A few commenters suggest that any use of penalty monies by the ERO would have the potential appearance of impropriety. For example, International Transmission prefers allocating penalty monies to rebuild transmission facilities damaged by natural

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[186] See, e.g., Alcoa, Ameren, ERCOT, FirstEnergy, NEPOOL Participants, New York Companies, NiSource and Santee Cooper.

[187] See, e.g., ISO/RTO Council, New York Companies and PacifiCorp.

[188] See also ELCON, PacifiCorp, Santee Cooper, Southern. New York Companies agree with such an approach and suggest that the violator not receive any benefit from a reduction in costs.

disasters. American Transmission and Michigan Electric state that penalty monies should go to the treasury of the regulator's government to eliminate any appearance of impropriety. Hydro One proposes that penalty monies assessed should be paid directly to the appropriate state or province for the benefit of the ratepayers.

624. TAPS suggests that, consistent with the practice of self-regulatory organizations, all or a portion of penalty monies may be used for restitution in cases where a violation of a Reliability Standard adversely affects identifiable and discrete victims. TAPS states that the Commission could include restitution in its interpretation of "appropriate sanctions" in section 215(c)(2) of the FPA. Similarly, Missouri Commission proposes that penalty monies be distributed to injured transmission customers or, if no specific harm is identified, to law-abiding transmission customers.

625. The Nova Scotia Board comments that the question of whether monies collected from Canadian participants should flow to the ERO or Regional Entity or remain in the jurisdiction should be considered. Hydro-Québec states that, in Canada, monetary penalties will be collected and used in accordance with arrangements between the ERO and Canadian authority. Ontario IESO recommends its current practice of using penalty monies to fund reliability-related educational programs or reducing the IESO's administration charge, so that the monies benefit end users in the region.

Commission Conclusion

626. The Commission believes 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.

627. The Commission, however, sees a disadvantage in directing that penalty monies offset a specific program, such as a compliance or enforcement program, as pointed out by many commenters. Rather, for an ERO or Regional Entity investigation, we find that the entity conducting the investigation must receive the penalty monies as an offset against its next year's budget for implementing FPA section 215. With this approach, the monies represent a savings to those consumers responsible ultimately for paying the costs of the ERO or Regional Entity.

628. An ERO candidate must describe in its certification application its proposed mechanism regarding this offset. The ERO candidate should explain how it would account for the receipt of penalty monies, the allocation of penalty monies resulting from any possible joint ERO/Regional Entity investigation, and other factors that would help the Commission to understand fully how the offset would operate. A delegation agreement must also contain the mechanism for the Regional Entity's offset. The ERO may propose a common method for all Regional Entities in any proffered pro forma delegation agreement.

629. For a Commission-initiated investigation, or one initiated on complaint to the Commission, any penalty monies must be directed to the U.S. Treasury.

iii. RTO/ISO-Related Enforcement Issues

630. Commenters raise several issues relating to the enforcement of the Commission's reliability-related regulations to RTOs and ISOs. For example, a number of commenters express concern regarding the application of a penalty to an RTO or ISO. NYISO comments that RTOs and ISOs, as not-for-profit, thinly capitalized entities, have virtually

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

no ability to pay financial sanctions out of their own resources.[189] Thus, NYISO contends that only a non-monetary penalty is appropriate for deterring or punishing a violation by an RTO or ISO. If a monetary penalty is imposed, the Commission should allow the pass-through of the monies because otherwise the RTO or ISO would face insolvency. It also suggests that the Commission discourage the ERO and Regional Entities from adopting Rules that penalize an RTO or ISO for a control area violation that is caused by a market participant and that the RTO or ISO is unable to prevent.

631. PG&E suggests that members of an RTO or ISO would ultimately bear the burden of any monetary penalty, and the Commission should therefore allow dues-paying members of such an RTO or ISO subject to a monetary penalty to request Commission review of the monetary penalty.

632. NYISO recommends that the Commission establish confidentiality rules that would prohibit a stakeholder board member of a Regional Entity from having access to market information obtained during a Regional Entity investigation that involves RTO or ISO markets. Alternatively, NYISO asks that, if a stakeholder board member of a Regional Entity is allowed access to such market information, the Commission establish strict confidentiality protections to ensure that a stakeholder board member does not make inappropriate use of sensitive RTO or ISO market data.

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[189] See also Alcoa, Kentucky Commission and National Grid.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

633. The City of Santa Clara questions whether the imposition of a penalty on an RTO would have any deterrent effect since it has no capital of its own and is strictly a "pass-through" entity. It comments that a better system of accountability is necessary to ensure that any penalty for misconduct is meaningful and effective for that entity. The City of Santa Clara questions whether the Commission, as the principal advocate of RTOs, can objectively impose sanctions on an RTO and asks that the Commission develop safeguards that minimize this conflict.

Commission Conclusion

634. While we recognize that RTOs and ISOs have some unique characteristics, we do not believe a generic exemption from any type of penalty is appropriate for any entity, including an RTO or ISO. The ERO or Regional Entity determining whether to impose a penalty on an RTO or ISO may consider the entity's unique characteristics, as well as the nature of the violation, in determining an appropriate and effective sanction.[190]

635. Further, we do not decide generically whether an RTO or ISO may pass a monetary penalty through to its members or customers. We will consider such an issue on a case-by-case basis. We find no merit in PG&E's suggestion that a dues-paying member of an RTO or ISO on which a penalty has been imposed be permitted to seek Commission review of a penalty. The FPA does not contemplate allowing a third-party

[190] See Enforcement of Statutes, Orders, Rules, and Regulations, 113 FERC ¶ 61,068 at P 20.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

to seek review of a penalty.[191] Moreover, PG&E does not provide a justification that is unique to RTOs and ISOs (for example, municipal entities and cooperatives that may be subject to monetary penalties may have similar concerns). Nor has PG&E provided any reason for us to believe that the RTO or ISO will not have sufficient incentive to defend its actions and seek review if appropriate.

636. With regard to NYISO's concern that RTOs and ISOs should not be penalized for control area violations that are caused by market participants and which RTOs and ISOs have no ability to prevent, we agree generally that entities should not be punished for violations that are not within their control. However, we will not make a generic ruling on this issue for all RTOs and ISOs. Rather, NYISO should raise these concerns with the ERO's or a Regional Entity's stakeholder process if it believes that a proposed Reliability Standard would make an RTO or ISO responsible for an action or occurrence outside its control.

637. NYISO's concerns about limits on access by a Regional Entity's stakeholder board to market information obtained during an investigation should be addressed by a Regional Entity when developing its bylaws or Regional Entity Rules.

638. The City of Santa Clara's comments on the Commission's objectivity to impose a sanction on an RTO is unfounded and lacks support.

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[191] Section 215(e)(2) of the FPA provides that a penalty "shall be subject to review by the Commission, on its own motion or upon application by the user, owner or operator that is the subject of the penalty. . . ."

8. Delegation to a Regional Entity - Section 39.8

639. Consistent with section 215(e)(4) of the FPA, the NOPR proposed that the ERO may enter into an agreement to delegate authority to a Regional Entity for the purpose of proposing to the ERO and enforcing Reliability Standards. Under the new system of mandatory Reliability Standards to be developed by the ERO, Regional Entities will, after entering into a Commission-approved delegation agreement, fulfill certain functions currently performed by the regional reliability councils.

640. The statute allows the ERO to delegate authority to a Regional Entity if: (1) the Regional Entity is governed by an independent board, a balanced stakeholder board, or a combination of the two; (2) the Regional Entity otherwise satisfies the criteria required for certification of the ERO; and (3) the agreement promotes effective and efficient management of the Bulk-Power System.

641. The NOPR sought comment on numerous aspects of the delegation of authority to a Regional Entity, including the role of a Regional Entity in relationship to the ERO, the criteria for becoming a Regional Entity, and the criteria for evaluating a Regional Entity applicant. The NOPR also asked whether a delegation agreement should be standardized and what degree of uniformity should be required for Regional Entity processes and governance.

a. The Role of a Regional Entity and its Relationship to the ERO

642. Consistent with section 215(a)(7) of the FPA, which defines a Regional Entity as an entity having enforcement authority pursuant to section 215(e)(4) of the FPA, the NOPR interpreted the statute to mean that the only delegated authority a Regional Entity

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

would possess would be the authority to enforce Reliability Standards approved by the Commission in a specific region.[192] The NOPR recognized that a Regional Entity may also propose a Reliability Standard to the ERO that, if ultimately approved by the Commission, would become an enforceable standard under the FPA. A Regional Entity may also propose a Reliability Standard to the ERO that would be applicable in a specific region. The NOPR requested comment on what the role of a Regional Entity should be in relationship to the ERO.[193] The NOPR also asked what, if any, additional authority a Regional Entity should be allowed beyond enforcement and proposal of Reliability Standards.[194]

Comments

643. Commenters differ on the appropriate role of a Regional Entity in relationship to the ERO. Many commenters emphasize the importance of a strong ERO at the top of the reliability hierarchy, while others endorse a relationship similar to the historical arrangement between NERC and the regional reliability councils. The majority of commenters support the Commission's interpretation of the statute that the authority delegated to a Regional Entity should be limited to enforcement and the proposal of Reliability Standards to the ERO.

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[192] NOPR at P 80.

[193] Id. at P 84 (delegation question 2).

[194] Id. at P 84 (delegation question 3).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

644. Several commenters contend that Reliability Standards should be developed and enforced on a top-down basis, with the Regional Entity the subordinate partner in the ERO-Regional Entity relationship.[195] These commenters describe a linear relationship between the Commission, the ERO and a Regional Entity, with the Regional Entity held accountable through the delegation agreement to the ERO for its delegated responsibilities. Michigan Electric suggests that the Regional Entity should be in the position of a subcontractor to the ERO for purposes of enforcement.

645. In contrast, other commenters support a strong regional organization similar to the existing relationship between NERC and the regional reliability councils.[196] They point to the vital role regional reliability councils have played in the development and enforcement of regionally-specific reliability criteria. NARUC contends that regional reliability council enforcement of compliance has worked effectively and cannot be duplicated at the continent-wide level. The Ohio Commission asserts that the Commission should adopt a rebuttable presumption that the existing structure is an appropriate starting point, while others go so far as to say that the ERO and the Commission should defer to decisions made by an Interconnection-wide Regional Entity with regard to delegated responsibilities.[197]

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[195] See, e.g., Alcoa, APPA, ELCON, Michigan Electric, NERC and TAPS.

[196] See, e.g., IEEE, NPCC and TANC.

[197] See, e.g., CREPC and Alberta.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

646. Some commenters advocate a relationship of equals between the ERO and a Regional Entity. For example, EEI suggests that a partnership between the Regional Entity and the ERO is appropriate because the broad range of reliability-related activities to be conducted by a Regional Entity are an essential part of the system by which reliability is maintained. Other commenters contend that the statute recognizes an Interconnection-wide Regional Entity as an equal partner in proposing Reliability Standards.[198]

i. Authority Delegated to a Regional Entity

647. The majority of commenters agree with the Commission's interpretation that the ERO may delegate authority to a Regional Entity under the statute, and would limit a Regional Entity's authority to proposing and enforcing Reliability Standards.[199] These commenters emphasize that the role of a Regional Entity should be well defined and limited to the functions specified in the statute.

648. Other commenters, such as PacifiCorp and NYSRC, believe that the Commission's interpretation of the role of a Regional Entity is too narrow. NYSRC contends that a Regional Entity's authority to develop and propose a Reliability Standard applicable to its region is no less important than its authority to enforce a Reliability Standard.

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[198] See, e.g., California Board and NPCC.

[199] See, e.g., AWEA, ERCOT, Exelon, International Transmission, LADWP, NiSource, Ontario IESO, PSEG Companies and SoCalEd.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

649. A few commenters argue that a Regional Entity should enforce, but not propose, Reliability Standards.[200] MISO asserts that a Regional Entity that does not encompass an entire Interconnection may develop a Reliability Standard that conflicts with the Reliability Standard of another Regional Entity within the same Interconnection. NiSource would limit a Regional Entity's authority to enforce a Reliability Standard to the specific Interconnection to which the Regional Reliability Standard applies.

650. Alcoa asserts that a Regional Entity should not undertake enforcement at all, but act only as a fact gatherer for the ERO.

651. The Oklahoma Commission comments that the statute is silent on which entity has ultimate responsibility for proposing and enforcing Reliability Standards and encourages the Commission to weigh this decision carefully.

ii. Other Regional Entity Activities

652. A number of commenters advocate permitting a Regional Entity to undertake functions that, although not explicitly delegated by the ERO, provide a beneficial service to the region, such as coordination of planning and operations, resource adequacy, maintaining databases, and transaction tagging services.[201] Some of these functions may support reliability, such as assessing reliability adequacy and performance, collecting and analyzing information, and educating market participants on reliability data. National

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[200] See, e.g., Ameren, AWEA and MISO.

[201] See, e.g., APPA, EEI, FRCC, Hydro One, National Grid, NERC and WECC.

Grid notes that NPCC establishes and maintains planning and resource adequacy criteria to require that the Bulk-Power System be designed for a regional loss of load expectation of no more than once in ten years, and asserts that, if the Commission were to prohibit Regional Entities from performing functions that complement the ERO's Reliability Standards, Bulk-Power System reliability could be undermined.

653. Other commenters, such as AEP and Exelon, would limit the role of a Regional Entity to functions explicitly delegated in the statute. Exelon emphasizes that there is no right to a delegation of authority beyond that which is clearly articulated in the statute.

Commission Conclusion

654. The Commission concludes that a strong ERO with primary responsibility for performing all reliability functions is the preferred model for ensuring Bulk-Power System reliability. We believe that having primary authority reside in the ERO is essential in establishing a continent-wide self-regulating reliability organization. It provides for an appropriate level of uniformity in Reliability Standard development and enforcement policies. Section 215(e)(4) of the FPA authorizes the ERO to delegate authority to a Regional Entity for the purpose of proposing Reliability Standards to the ERO and enforcing Reliability Standards. The statute assumes a strong ERO, which generally will be responsible for all enforcement activities unless and until the ERO delegates its authority. Thus, the ERO retains responsibility to ensure that a Regional Entity implements its enforcement program in a consistent manner and will require a Regional Entity to file periodic reports on enforcement investigations, as specified in the Final Rule's provisions on Enforcement of Reliability Standards. We require the ERO to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

formally review a regional Reliability Standard proposed by a Regional Entity. Only the ERO may submit a proposed Reliability Standard to the Commission.

655. The Commission disagrees with commenters who suggest that a Regional Entity should not be allowed to propose a Reliability Standard. Although anyone, including a Regional Entity, may propose a Reliability Standard to the ERO for its consideration, section 215(e)(4) of the FPA requires the Commission to authorize the ERO to enter into a delegation agreement for the purpose of, inter alia, proposing Reliability Standards. Therefore, we affirm our statement in the NOPR that a Regional Entity may propose a Reliability Standard to the ERO.

656. While the ERO may not delegate other statutory functions to a Regional Entity, the Commission will not prohibit a Regional Entity from performing other reliability-related functions in service to its region. As commenters indicate, regional reliability councils currently perform a number of functions beyond the proposal and enforcement of Reliability Standards. A Regional Entity may conduct such activities, provided that they do not conflict or interfere with the performance of a delegated function, which we view as the primary mission of a Regional Entity.

657. Further, any additional activity must not compromise the oversight role or the independence of the Regional Entity. The activity itself must not present a conflict of interest with the Regional Entity's reliability oversight role of transmission operators. Further, the funding for the activity must not be of such a significant amount or from such a source as to compromise the independence of the Regional Entity. Other activities

not explicitly authorized under section 215 of the FPA may not be funded through the ERO.

b. Process and Criteria for Becoming a Regional Entity

658. Section 215(e)(4) of the FPA requires the Commission to issue regulations authorizing the ERO to enter into an agreement to delegate authority to a Regional Entity by filing a delegation agreement with the Commission. The filing must include a detailed statement demonstrating that: (1) the Regional Entity is governed by an independent board, a balanced stakeholder board, or a combination thereof; (2) the Regional Entity otherwise satisfies the certification provisions of section 215(e)(4) of the FPA; and (3) the agreement promotes effective and efficient administration of Bulk-Power System reliability. The statute also requires the Commission and the ERO to rebuttably presume that a proposal for a delegation to a Regional Entity organized on an Interconnection-wide basis promotes effective and efficient administration of Bulk-Power System reliability and should be approved.

659. Further, the NOPR sought comment on whether the Commission or the ERO should set the criteria by which a Regional Entity application[202] to the ERO should be reviewed.[203] The NOPR also asked what criteria should be used to determine whether an applicant is eligible to become a Regional Entity. Further, the NOPR asked whether the

[202] By application, the Commission means the ERO delegation process specified in proposed 18 CFR 38.7.

[203] NOPR at P 84 (delegation question 9).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission should prescribe a size, scope, or configuration requirement for a Regional Entity and, if so, what it should be.[204]

Comments

660. The Texas Commission asks the Commission to be more specific as to how Regional Entities are established and approved. It suggests that the Commission should consider an application process similar to the one described in the NOPR for the ERO.

661. As to the criteria for becoming a Regional Entity, commenters are divided on who should set the criteria by which a Regional Entity will be evaluated. A number of commenters suggest that the Commission should set the criteria by which a Regional Entity application is reviewed because the Commission is ultimately responsible for approving all delegations of authority from the ERO to a Regional Entity.[205] Other commenters respond that the ERO should develop the criteria by which a Regional Entity application is reviewed, noting that each Regional Entity's delegation agreement will be subject to Commission approval.[206]

662. The majority of commenters ask the Commission not to prescribe a size, scope and configuration requirement, arguing that the Commission should decide the appropriateness of a Regional Entity's size, scope or configuration on a case-by-case

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[204] Id. (delegation question 1).

[205] See, e.g., Alcoa, California ISO, EEI, PSEG Companies and Ontario IESO.

[206] See, e.g., ERCOT, LADWP, SERC and South Carolina E&G.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

basis.[207] These commenters suggest that the Commission should provide flexibility in allowing a Regional Entity candidate to demonstrate that it meets the standards of section 215(e)(4) of the statute, explaining that Regional Entity configuration is less important than consistency in enforcement of ERO Reliability Standards across an Interconnection. Hydro-Québec emphasizes that the Commission should work together with the appropriate Canadian authorities on a case-by-case basis to determine whether an applicant should be a Regional Entity. Several commenters believe the Commission should prescribe the size, scope and configuration of a Regional Entity.[208] Most of these commenters contend that a Regional Entity should be Interconnection-wide. AWEA explains that industry participants are currently burdened by facing different Reliability Standards in each regional reliability council and notes that clear and consistent Reliability Standards across the continent would allow wind turbine manufacturers to produce turbines at a much lower cost to customers.

663. A number of commenters emphasize the importance of preserving the benefits of the regional reliability councils and argue that deference should be given to applications from existing regional reliability councils.[209] For example, South Carolina E&G

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[207] See, e.g., APPA, City of Seattle, EEI, FRCC, Hydro-Québec, ISO New England, ISO/RTO Council, NiSource, NYSRC, PacifiCorp, SMUD, TAPS and Xcel.

[208] See, e.g., Alcoa, Ameren, AWEA, BCTC and CREPC.

[209] See, e.g., Cinergy, ERCOT, Hydro One, MISO Owners, NPCC, Ohio Commission, South Carolina E&G and TVA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

advocates that the regional reliability councils should become Regional Entities and asserts that the "essential weakness of the current system lies in its voluntariness, not in the number of reliability councils."[210]

664. TVA submits that there should be a rebuttable presumption that regional reliability councils are the appropriate starting point for Regional Entities.[211] It notes the importance of establishing Regional Entities in a cost-effective manner and suggests that the Commission should require evidence of problems before making changes to the current regime.

665. To the contrary, ELCON admonishes the Commission against preserving the "outmoded, existing industry governance structures, relationships, and habits" in setting requirements for a Regional Entity.[212] In a similar vein, EPSA urges the Commission to avoid the "status quo quilt of decentralized, disparate entities."[213]

666. A number of commenters suggest specific criteria for evaluating a Regional Entity applicant.[214] They cite a number of factors, including governance, staff expertise, balance and diversity of interests in the Reliability Standard development process,

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[210] South Carolina E&G at 6.

[211] See also Cinergy and Ohio Commission.

[212] ELCON at 3.

[213] EPSA at 12.

[214] See, e.g., APPA, Hydro One, MISO, Missouri Commission and NERC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

sufficiency of resources and support systems, security of finances, and track record with reliability issues. Some commenters also suggest that the Commission consider whether a Regional Entity has demonstrated that it has received approval from ANSI as a standards-setting organization, which would help to ensure that a Regional Entity's Reliability Standard development process is fair, open, balanced and inclusive.[215]

667. NERC points to the criteria in the bilateral principles, which call for a Regional Entity with a size or scope that facilitates cross-border trade and has boundaries that encompass the boundaries of other transmission organizations.

668. A few commenters recommend other criteria. For example, the Missouri Commission suggests that there should be no more than two Regional Entities per state; a Regional Entity should include a multi-state geographic area that encompasses the major electric markets for a region; or the region should be electrically connected with respect to scope. Some commenters, such as NERC and NPCC, point to the benefits of a Regional Entity with boundaries that encompass the boundaries of an RTO or ISO to avoid the creation of new seams. In this regard, MISO suggests that the entire geographic region of an RTO should be within the scope of one Regional Entity.

669. Some commenters suggest that, rather than prescribing size, scope and configuration requirements, the Commission should focus on the criteria prescribed in the

[215] See, e.g., APPA and EPSA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

legislation.[216] National Grid submits that the Commission's analysis should follow the statutory criteria for a Regional Entity. International Transmission agrees, arguing that additional requirements are unnecessary since the statute and proposed regulations already provide that an Interconnection-wide Regional Entity will be accorded certain deference with regard to Reliability Standards proposed to be implemented on an Interconnection-wide basis.

Commission Conclusion

670. The Final Rule adopts the criteria set out in section 215(e)(4) of the statute. Regional Entity applicants must enter into a delegation agreement with the ERO. The ERO should evaluate the Regional Entity applicant according to the statutory and regulatory criteria. Once the ERO has signed a delegation agreement with a Regional Entity, the ERO will submit it to the Commission for approval.

671. The Commission agrees with those commenters who argue that the statute provides adequate criteria for Regional Entities. The Commission does not set criteria in the Final Rule for a Regional Entity's size, scope and configuration, but will evaluate each Regional Entity application on a case-by-case basis. Any change in the size, scope or configuration of a Regional Entity would constitute an amendment to the delegation agreement, and any amendment would be subject to review by the ERO and approval by the Commission. Section 215(e)(4) of the FPA requires a Regional Entity to have an

[216] See, e.g., APPA, International Transmission and National Grid.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

independent board, a balanced stakeholder board or a combination of the two; satisfy the same requirements as the ERO; and demonstrate that the proposed delegation agreement promotes effective and efficient administration of Bulk-Power System reliability. We do not provide guidance in this Final Rule as to what constitutes "effective and efficient administration." We believe it more appropriate to address the issue in the context of the particular facts and circumstances presented by an individual proposed delegation agreement. Further, the Commission prefers that the ERO make the initial assessment of each Regional Entity applicant, and present its case to the Commission. The Commission will conduct the final assessment.

672. The statute requires, and we adopt here, a rebuttable presumption that a proposal for delegation to a Regional Entity organized on an Interconnection-wide basis promotes effective and efficient administration of Bulk-Power System reliability and should be approved, as discussed further below.

673. As a general matter, the ERO will initially assess whether a regional reliability council may become a Regional Entity, subject to Commission approval. When this issue comes before the Commission, it will consider a delegation agreement between the ERO and an existing regional reliability council in light of whether the application demonstrates compliance with the criteria to qualify as a Regional Entity. The Commission may consider reconfiguration or consolidation if a specific problem is raised in the approval process, or subsequently if inadequate scope or configuration or other factors hamper the performance of delegated responsibilities of a Regional Entity or fail to promote effective and efficient administration of the Bulk-Power System.

c. Review of a Regional Entity Applicant

674. As noted above, EPAct provides criteria to be met by a Regional Entity applicant, including the rebuttable presumption that a proposal for a delegation to a Regional Entity organized on an Interconnection-wide basis promotes effective and efficient administration of Bulk-Power System reliability.

i. Review of a Regional Entity Organized on an Interconnection-wide Basis

675. The California ISO contends that section 215 of the FPA accords an Interconnection-wide Regional Entity only a rebuttable presumption that it satisfies one of the statutory criteria required for approval, effective and efficient administration of the Bulk-Power System.

Commission Conclusion

676. We agree with the California ISO's comment that the rebuttable presumption that the proposed delegation agreement be approved applies only to one of the statutory criteria. The Commission concludes that the most reasonable interpretation of the provision is that the rebuttable presumption applies only to the effective and efficient administration of the Bulk-Power System criterion. However, parties are free to intervene and make the case that a delegation agreement should not be approved if it fails to satisfy this, or any of the other statutory or regulatory criteria.

ii. Review of a Regional Entity Not Organized on an Interconnection-wide Basis

677. The NOPR asked whether a higher standard of review should apply to a proposed Regional Entity that is not organized on an Interconnection-wide basis, given that section

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

215(e)(4) of the FPA requires that the ERO and the Commission must rebuttably presume that a proposal for a Regional Entity organized on an Interconnection-wide basis promotes effective and efficient administration of Bulk-Power System reliability, and if so, what the higher standard of review should specify. The NOPR also asked whether a Regional Entity not organized on an Interconnection-wide basis should have the burden to demonstrate that it has the appropriate regional scope and configuration to promote effective and efficient administration of Bulk-Power System reliability.[217]

Comments

678. Several commenters support a higher standard of review for a Regional Entity that is not organized on an Interconnection-wide basis. Numerous other commenters do not see a need to distinguish Regional Entity criteria according to whether or not a Regional Entity is Interconnection-wide.

679. Several commenters support a higher standard of review for a Regional Entity that is not Interconnection-wide.[218] For example, CREPC asserts that the Commission should clearly separate the authorities and responsibilities of a Regional Entity that oversees an entire Interconnection from those that only oversee a portion.

680. Many other commenters see no reason to differentiate Regional Entity criteria according to whether or not the Regional Entity is organized on an Interconnection-wide

[217] NOPR at P 84 (delegation question 9).

[218] See, e.g., Ameren, AWEA, CREPC, EEI and NiSource.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

basis.[219] FRCC submits that the Commission should not set a standard of review beyond that in EPAct because the Act does not require a higher standard of review for the approval of a Regional Entity that is not organized on an Interconnection-wide basis. Rather, it establishes a procedural requirement for the burden of going forward with evidence and argument on whether the delegation standard has been met. MISO Owners argue that the Commission should refrain from setting a higher standard of review because there is no real difference between Interconnection-wide reliability organizations and today's Eastern Interconnection organizations in terms of technical expertise. Dairyland adds that a Regional Entity not organized on an Interconnection-wide basis should get the same deference as one organized on an Interconnection-wide basis if it can demonstrate the knowledge and technical expertise to warrant deference, and is structured to operate independently from members, market participants, and system operators. However, a Regional Entity that is not a part of a larger Interconnection may need more extensive coordination specificity requirements.

681. The California ISO asserts that the statute does not require a higher substantive standard of review for a Regional Entity not formed on an Interconnection-wide basis.

682. Other commenters argue that the Commission must give due consideration to entities that are less than Interconnection-wide. SERC asserts that there is a long-

[219] See, e.g., California ISO, FRCC, MISO Owners, National Grid, NYSRC and Ontario IESO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

standing historical precedent for smaller regions with legitimate local reliability concerns that would not be adequately addressed by a larger, more encompassing region.

683. Commenters offer a number of suggestions on criteria for a higher standard of review. Numerous commenters recommend that Regional Entity qualifications should be based on the EPAct principle of effective and efficient administration of Bulk-Power System reliability, emphasizing that the statute already provides this criterion.[220] Commenters encourage the Commission to afford appropriate weight to the technical expertise of a proposed Regional Entity that is less than Interconnection-wide.[221]

684. EPSA recommends that Regional Entity approval be based on the existence of consistent and uniform Reliability Standards and procedures. It contends that uniformity is particularly important in cases where several Regional Entities exist within an Interconnection.

Commission Conclusion

685. The Commission concludes that a Regional Entity that is not Interconnection-wide must meet the same criteria as one organized on an Interconnection-wide basis. However, it has the burden to demonstrate effective and efficient administration of Bulk-Power System reliability, since no rebuttable presumption applies for this criterion. Accordingly, the Commission expects a proposed delegation to a Regional Entity not

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[220] See, e.g., AEP, Alberta, APPA, EEI, FRCC, LADWP, National Grid, PacifiCorp and Xcel Energy.

[221] See, e.g., CREPC, ISO New England and LG&E Energy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

organized on an Interconnection-wide basis to affirmatively demonstrate that such delegation meets all the statutory criteria and in particular would promote "effective and efficient administration of Bulk-Power System reliability." We note that an Interconnection-wide Regional Entity offers the greatest potential for effective reliability without seams.

686. The Commission disagrees with commenters suggesting that we establish a generic distinction in our regulations between the authorities and responsibilities of an Interconnection-wide Regional Entity and one that is less than Interconnection-wide. Once approved, any Regional Entity will be delegated the authorities and responsibilities articulated in its own Commission-approved delegation agreement.

d. Eligibility of an RTO or ISO to Become a Regional Entity

687. The NOPR asked whether an RTO or ISO should be permitted to become a Regional Entity.[222] It noted that the bilateral principles provide that an RTO or ISO should not become a Regional Entity, and that a Regional Entity should be distinct from an operator of the system, such as an RTO or ISO.

Comments

688. Several commenters ask the Commission not to preclude generically an RTO or ISO from becoming a Regional Entity, but rather allow them to present arguments and

[222] NOPR at P 71 (enforcement question 9).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

plans to address any necessary separation requirements.[223] They note that the statute does not specifically preclude an RTO or ISO from serving as a Regional Entity and assert that the Commission should not rely solely on the bilateral principles as a basis for such preclusion. Alcoa points out that having a separate RTO/ISO and Regional Entity could lead to duplicative efforts and higher costs for consumers.

689. The California ISO contends that an RTO or ISO is well-positioned to serve as a Regional Entity because it must satisfy independence requirements, has the necessary expertise and knowledge of regional conditions, already has reliability obligations under Order No. 888, is of sufficient size and scope to serve as a Regional Entity, and has Commission-approved enforcement programs. It further contends that an RTO or ISO could satisfy the concerns expressed in the bilateral principles through functional separation of compliance units that would be autonomous of ISO/RTO management. Alternatively, the ERO could be made responsible for monitoring the compliance of an RTO or ISO that serves as a Regional Entity.

690. Some commenters, including ERCOT and SPP, argue that it is appropriate for an ISO or RTO to be a Regional Entity under certain conditions. SPP cites its success in operating as a combined RTO and regional reliability council and notes the efficiencies of a combined organization. SPP claims that its structure satisfies the independence requirement for a Regional Entity, explaining that the sole function of its compliance

[223] See, e.g., Alcoa, Empire District Electric, Hydro-Québec, Kansas City P&L, Missouri Commission and Ontario IESO.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

monitoring staff is to comply with Reliability Standards. SPP compliance staff does not participate in enforcement audits of the SPP system operator and three independent directors adjudicate the assessment of penalties to SPP participants. The Ontario IESO similarly notes that it serves as a system operator and oversees compliance with Reliability Standards, with its enforcement unit insulated from the rest of the organization. It claims that its process has been effective, noting that compliance enforcement involves technical matters that only the system operator fully understands.

691. ERCOT and others assert that ERCOT should be able to maintain its ISO and Regional Entity functions within the same organization. They explain that Texas state law grants the Texas Commission authority to adopt and enforce reliability rules. The Texas Commission has delegated this authority to ERCOT, subject to its oversight. ERCOT is uniquely situated because it has no AC interconnections to neighboring control areas, it has a compliance office that is functionally separated from the ISO organization, and the Texas Commission answers directly to the state legislature on Bulk-Power System reliability.

692. Many commenters admonish the Commission against allowing a combined system operator/Regional Entity.[224] NRECA notes, "There is already ample concern that RTOs and related entities have become too overstaffed, too large, and too unaccountable to the

[224] See, e.g., Alberta, BCTC, CEA, Ohio Commission, Old Dominion, PG&E, NRECA, SMUD, Southern and TVA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

public. Endowing RTOs with additional powers and duties can only exacerbate these problems at this time."[225]

693. Many commenters, such as New York Companies, express the concern that an RTO's or ISO's operational duties would conflict with the Regional Entity role of enforcing Reliability Standards. Commenters, such as Alberta and SMUD, contend that since an RTO or ISO will have to comply with Reliability Standards in its role as a transmission operator, balancing authority and security coordinator, such an entity should not also act as a Regional Entity. They argue that it is not appropriate for a Regional Entity to exercise its enforcement authority against itself. APPA and Old Dominion comment that functional separation and behavioral criteria will not suffice should an RTO or ISO seek to act as a Regional Entity. Despite any devices used to address the independence issue, industry participants may still lack confidence that a Regional Entity is competent to discipline its Bulk-Power System operations function. SMUD adds that functional separation would require a new layer of enforcement that would impose additional costs on market participants.

694. EPSA suggests that an RTO seeking to qualify as a Regional Entity must satisfy a heavy burden, including complete detachment of the enforcement function from RTO operations. It suggests that other criteria to consider in determining whether an RTO meets this heavy burden include detailed, written procedures for the separation of

[225] NRECA at 33.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

functions; a determination of whether a delegation is limited to ERO functions that do not require the RTO to serve as the reliability compliance monitor for itself; and periodic audits that provide independent verification that an RTO is performing its dual roles properly.

695. Hydro-Québec suggests that an RTO or an ISO may be a Regional Entity if it can demonstrate its independence from the enforcement authority in the region. MRO contends that the Commission should prohibit an RTO or ISO from becoming a Regional Entity unless such a requirement conflicts with a state or provincial mandate, as is the case with ERCOT.

696. CEA and Hydro Québec express concern about the implications for Canadian companies of having a combined system operator/Regional Entity. They warn that allowing an RTO or an ISO to become a Regional Entity should not be used to force Canadian utilities to become members of an RTO or ISO. Further, CEA comments that allowing an RTO or ISO to become a Regional Entity could serve as a disincentive for Cross-Border Regional Entities to the extent Canadian utilities may be unable or unwilling to transfer operational authority to an RTO or ISO.

Commission Conclusion

697. The Commission considers the matter of whether a combined system operator/Regional Entity is able to engage in both separate system operations and enforcement as distinct from the matter of whether the boundaries of an RTO or ISO correspond to the boundaries of a Regional Entity. The Commission recognizes the potential benefits of having the same boundaries for an RTO/ISO and a Regional Entity.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

698. The Commission is concerned, however, that an RTO or ISO may have an inherent conflict of interest if it is also a Regional Entity itself. The same institution would operate the Bulk-Power System and be responsible for overseeing its own compliance with Reliability Standards. The comments received reinforce the Commission's opinion that such self-enforcement is extremely difficult to carry out satisfactorily. A system operator/Regional Entity in a single corporation – absent a very strong separation between the oversight and operations functions – should not oversee its own compliance with Reliability Standards.

699. We will not in the Final Rule prohibit an entity from making its case for adequate separation. However, an RTO or ISO that lies in whole or in part in the United States and applies to become a Regional Entity will have a heavy burden to show that it meets the statutory criterion that it be independent of the operators of the Bulk-Power System in its region.[226]

700. A combined system operator/regional reliability council currently in operation may seek Regional Entity status but, to qualify as a Regional Entity, it must demonstrate a strong separation plan with sufficient protections. The separation plan must show full independence between the enforcement/Reliability Standard development and the

[226] The Commission acknowledges the existence of two such combined entities in the United States today. Although commenters note that an operating entity in Canada may enforce reliability rules against itself, we know of no case where such an entity seeks to become a Regional Entity. In any event, how such matters are decided in Canada is outside our jurisdiction.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

transmission operations. If a combined system operator/Regional Entity cannot demonstrate adequate separation, it will not be approved.

e. Delegation Agreements

701. Paragraphs (b) and (c) of the NOPR's proposed section on delegation provided that the ERO must file a delegation agreement with the Commission for approval and that the delegation agreement shall not be effective until it is approved by the Commission.

702. The NOPR asked whether the ERO should be required to submit a standardized form of delegation agreement concurrently with the ERO application that would delineate a uniform relationship between the ERO and all Regional Entities. Alternatively, should all of a delegation agreement be tailored to the individual needs and circumstances of each region and the ERO?[227]

703. The NOPR also asked what guidelines, measures or criteria to apply in determining whether a delegation agreement promotes effective and efficient administration of Bulk-Power System reliability. If the primary function of a Regional Entity is enforcement of Reliability Standards, in what ways will Regional Entities bring effective and efficient administration in the enforcement function?[228]

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[227] NOPR at 84 (delegation question 4).

[228] Id. (delegation question 11).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Comments

704. Most commenters on delegation agreements support some sort of standardized delegation agreement, while others assert the need for an individualized delegation agreement for each Regional Entity. A number of commenters support a pro forma delegation agreement, which would define certain standardized criteria to be consistent across all Regional Entities.

705. Commenters, such as EPSA and FirstEnergy, emphasize the importance of uniformity with respect to enforcement of Reliability Standards, and for processes and procedures implemented by all Regional Entities. EPSA notes that standardization can facilitate transactions across regions, cut costs and avoid litigation. EPSA asserts that variations in Regional Entity delegation agreements should be rare, and thus it should be possible to standardize major elements of the delegation agreement.

706. A number of commenters would not standardize the delegation agreement, instead asserting that a Regional Entity must have the flexibility to develop an individual delegation agreement.[229] Many of these commenters believe the Commission should allow entities considerable latitude to negotiate these agreements, and should not create a disincentive to innovation.

[229] See, e.g., Alberta, BCTC, City of Seattle, ISO/RTO Council, Kansas City P&L, PacifiCorp and TANC.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

707. CEA and Hydro-Québec prefer individualized delegation agreements because a uniform delegation agreement may not reflect the differing authorities of a Cross-Border Regional Entity.

708. A number of commenters assert that Regional Entity delegation agreements need to be flexible enough to accommodate regional differences.[230] Progress Energy submits that the delegation agreement should specify a uniform relationship between the ERO and Regional Entity but should also provide enough flexibility to allow for the individual needs and circumstances of each region. APPA asserts that additional terms and conditions addressing the unique circumstances of a region could be spelled out in addenda to the pro forma delegation agreement.

709. ERCOT and WECC suggest that the delegation of authority to a Regional Entity that is organized on an Interconnection-wide basis should be allowed more flexibility than one for a Regional Entity that is less than Interconnection-wide. They assert that the Commission should allow the ERO and an Interconnection-wide Regional Entity to negotiate an individual delegation agreement that reflects its unique system needs and give it broader responsibility for readiness audits and assessments of reliability in its region.

710. Numerous commenters favor a pro forma agreement, to be submitted concurrently with the ERO application, to maximize consistency among Regional Entity delegation

[230] See, e.g., Ameren, APPA, Progress Energy, SERC and Southern.

agreements.[231] The ERO would identify specifically how each region meets the qualification criteria and would include the Rules of procedure used within the region for delegated functions.

711. International Transmission and Michigan Electric are concerned that delegations to Regional Entities create opportunities for the development or enforcement of Reliability Standards to vary by region. They assert that undue influence by individual stakeholders or stakeholder sectors, the Regional Entities themselves, or even the Commission could compromise grid reliability, and argue that a prerequisite to any delegation of authority to a Regional Entity should be a finding that the ERO is fully independent with respect to its review and that any specific delegation of authority does not undermine such independence.

Commission Conclusion

712. As most commenters observe, there is value to consistency among the delegation agreements of Regional Entities. Industry participants should be able to conduct business in the same way from one Regional Entity to the next. Some standardization of the delegation agreement will facilitate uniformity in ERO-Regional Entity relationships, Regional Entity processes, accountability and enforcement of Reliability Standards. It may also help to minimize seams between regions. The Commission concludes that the ERO should submit a pro forma delegation agreement. This is a delegation agreement

[231] See, e.g., AEP, EEI, Hydro One, International Transmission, NERC, NPCC, SoCalEd, TVA and Xcel Energy.

with core elements to be uniformly applied to all Regional Entities. The ERO applicant must submit the pro forma delegation agreement concurrently with the ERO application. Addenda to the delegation agreement can address regional differences and unique system needs for each Regional Entity, including any need to address differing authorities of Cross-Border Regional Entities.

713. The Commission sees no need to make a finding that the ERO is fully independent as part of the delegation of authority to Regional Entities, as suggested by International Transmission and Michigan Electric. The Commission will evaluate such criteria during the ERO certification process.

f. Regional Entity Governance

714. The NOPR asked to what extent the ERO, when delegating responsibility to a Regional Entity, should require uniform processes with regard to governance, among other things.

715. The NOPR also asked whether the delegation criteria for a Cross-Border Regional Entity should specify that each country represented in the region should have the opportunity to have members from the country on the board of the Cross-Border Regional Entity in numbers that reflect the country's approximate percentage of net energy for load in that region, similar to that provided in the bilateral principles.[232]

[232] NOPR at P 84-88 (delegation question 8).

Comments

716. A number of commenters emphasize the importance of governance and request additional guidance from the Commission on how a Regional Entity would be governed. MISO asserts that the NOPR does not contain sufficient detail to ensure that a Regional Entity is properly structured and not dominated by any particular industry sector. TAPS asks for guidance on the statutory requirement for balanced stakeholder or hybrid boards at the Regional Entity level and public meeting requirements. It also requests that the Commission spell out the meaning of the "balance" requirement, consistent with Order Nos. 888 and 2000 and the bilateral principles.

717. EPSA emphasizes that a Regional Entity must be independent and notes the difficulty of achieving true independence with a stakeholder board and a committee process that is staffed primarily by employees of grid operators or market participants. EPSA encourages the Commission to require boards that properly balance the interests of all users, owners and operators of the Bulk-Power System.

718. Commenters stress the importance of a Regional Entity developing a fair system of sector representation and voting as a requirement for approval of a delegation agreement. ELCON advocates that the Commission require NERC's governance structure for a Regional Entity which organizes stakeholders into nine representative industry sectors. It asserts that end users should be permitted to participate in the affairs of a Regional Entity on an equal and non-discriminatory basis to meet statutory objectives, and observes that a membership requirement can be a barrier to participation.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

719. NASUCA submits that consumer representatives should be entitled to membership and voting rights in any Regional Entity that is delegated ERO functions. Consumers should be fully represented on the stakeholder committees that advise the board of any Regional Entity that has an independent board.

720. The California ISO requests that the Commission confirm that its new board selection process satisfies the independence requirement under section 215(e)(4)(B) of the FPA and the proposed regulations in the event it seeks to become a Regional Entity.

721. NPCC asserts that a delegation agreement should not prescribe a Regional Entity's governance beyond the requirement that it fairly represent the composition of its region.

722. While some commenters support a requirement that the number of board members of a Cross-Border Regional Entity must be in proportion to net energy for load for each participating country, other commenters argue that the Commission should not dictate such a structure for a Cross-Border Regional Entity's board.

723. Alberta, BCTC, Hydro One, and Hydro Québec believe that the delegation criteria for a Cross-Border Regional Entity should specify that each country should be allowed membership based on net energy for load in each region. PSEG Companies agrees, but adds that the number of representatives should be roughly proportional to load and not less than one.

724. Ontario IESO recommends specifying a minimum number of Canadian board seats for Cross-Border Regional Entities, rounded up from the proportion of net energy for load.

725. WECC strongly endorses the notion that international members should have assured representation on a Cross-Boarder Regional Entity's board, but expresses concern about requiring a Regional Entity to have a governing board based strictly on net energy for load. WECC's current bylaws do not require that representation be based strictly on the net energy for load proportion. WECC explains that its board is composed of a delicate balance of combined stakeholder and nonaffiliated members and asserts that the Final Rule should permit delegation to a Cross-Border Regional Entity in a manner that will accommodate current WECC bylaws.

726. APPA argues that the Commission should not specify the details of a Cross-Border Regional Entity's board membership in the Final Rule to allow flexibility in the structure of a Regional Entity's board as intended in the statute. Instead, it suggests that the Commission could state in the preamble to the Final Rule that it would accept a division of representation on a Cross-Border Regional Entity's board based on net energy for load in each country.

Commission Conclusion

727. Section 215(e)(4)(A) of the statute provides criteria for the governance of a Regional Entity. As noted above, the statute directs the Commission to issue regulations authorizing the ERO to enter into a delegation agreement between the ERO and a Regional Entity if, inter alia, the Regional Entity is governed by an independent board, a balanced stakeholder board, or a combination of the two. The statute provides no further guidance on Regional Entity governance. The Commission observes that there may be more than one acceptable approach for a Regional Entity to establish a balanced or

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

combination board. The Commission does not give further guidance regarding the statutory criteria for Regional Entity governance here. Instead we will interpret the statutory criteria in light of the facts presented in each Regional Entity's proposed delegation agreement. It is premature for the Commission to make a finding on any particular Regional Entity governance at this time.

728. As explained above, just as the Commission requires an ERO candidate to demonstrate in its application for certification how it will establish Rules that ensure its independence from the users, owners and operators of the Bulk-Power System, while assuring stakeholder representation in the selection of its directors and balanced decisionmaking in any ERO committee or subordinate organizational structure, we also adopt this requirement to demonstrate these factors in each Regional Entity delegation agreement. The Commission agrees that appropriate Regional Entity Rules should include a provision specifying that no two industry sectors should control any decision and no single segment should be able to veto any matter, unless the ERO adequately explains why it cannot apply these principles.

729. We note that the ERO may seek recognition for a Cross-Border Regional Entity applicant in Canada and Mexico, in accordance with the relevant requirements of the Canadian and Mexican authorities. We see no reason to differ for a Cross-Border Regional Entity regarding our conclusion above not to further interpret the statutory Regional Entity governance criteria.

g. Notice Requirement for Submission of Delegation Agreements

730. NiSource comments that the NOPR was silent as to the process the Commission will use to approve the ERO's proposed delegation of authority to a Regional Entity. Although the proposed regulations would require the ERO to file with the Commission a delegation agreement, the NOPR did not propose a notice requirement or provision for public comment or protest regarding the filing. NiSource requests clarification that any proposed delegation agreement or Regional Entity Rule will be subject to notice and public comment.

731. PG&E requests that the Commission modify the proposed regulations to include explicitly the opportunity for public notice and comment on an application to become the ERO and a proposed delegation agreement between the ERO and a Regional Entity.

Commission Conclusion

732. The Commission will provide notice and opportunity for comment on an ERO application and a proposed delegation agreement. Interested persons will have an opportunity to express their concerns about the application or agreement. The Commission will consider all interventions and comments in making an informed decision on whether to accept a delegation agreement.[233]

[233] Notice and comment procedures are to be under Rule 210 of the Commission's rules of practice and procedure. 18 CFR 385.210.

h. Uniform Processes Among Regional Entities

733. The NOPR asked about the extent to which the ERO, when delegating responsibility to Regional Entities, should require uniform processes in matters including, but not limited to, governance, collection of dues and fees, compliance monitoring, and enforcement action procedures.[234]

Comments

734. Comments on this matter largely overlap the comments discussed above under Delegation Agreement and Governance. A number of commenters support a standardized process across Regional Entities.[235] These commenters emphasize the need for uniformity in processes, especially those relating to governance, collection of dues and fees, compliance monitoring and enforcement proceedings, and hearing procedures. Commenters, including EEI and NERC, note that NERC and the industry are preparing a proposed pro forma delegation agreement that should specify the necessary uniform processes within the Regional Entities.

735. EPSA argues that the ERO should require, and the Commission should condition Regional Entity approval on, the establishment of consistent and uniform standards and procedures. NiSource and PSEG Companies stress the importance of consistency for stakeholders that do business in multiple regions.

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[234] NOPR at P 84 (delegation question 5).

[235] See, e.g., EEI, ELCON, FRCC, EPSA, NERC and NiSource.

736. Other commenters do not believe absolute standardization is necessary.[236] Rather, they argue, the responsibilities delineated in the relationship between the ERO and Regional Entities should have a common look and feel, but standardization should not be overly prescriptive. First Energy submits that the Commission should allow flexibility in the implementation of uniformity, such as for self-assessment programs and the development of best practices.

Commission Conclusion

737. As noted above under the Delegation Agreements and Governance, the Commission will review the pro forma delegation agreement when it is filed by the ERO applicant. The pro forma delegation agreement must propose which regional processes should be standardized. The Commission believes that regional processes should be uniform unless regional facts, other than custom, require a difference.

i. Commission Assignment of Enforcement Authority Directly to a Regional Entity

738. The NOPR proposed that, if a prospective Regional Entity seeking to enter into a delegation agreement with the ERO is unable to reach agreement with the ERO within 180 days, and the entity can demonstrate that continued negotiations would not likely result in a delegation agreement within a reasonable period of time, such entity may

[236] See, e.g., Ameren, Progress Energy, Santee Cooper, SERC and SoCalEd.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

apply to the Commission directly for authority to enforce Reliability Standards within a region.[237]

Comments

739. Among the commenters on assignment of enforcement authority directly to a Regional Entity, Hydro-Québec expresses general support for the Commission's proposal to allow a Regional Entity to apply directly to the Commission for enforcement authority if a delegation agreement cannot be reached within 180 days. EPSA emphasizes that the entity making such a direct application to the Commission must demonstrate that its dealings with the ERO were conducted in good faith and with the goal of minimizing areas in dispute.

740. The ISO/RTO Council notes that the Commission does not explain or justify the proposed requirement that a prospective Regional Entity wait 180 days after proposing a delegation agreement to the ERO before seeking Commission action and questions why such a waiting period is necessary. It recommends deleting the words "within 180 days" from proposed section 38.7(e).

741. APPA questions whether the statute clearly authorizes the Commission to determine the terms and conditions of a delegation agreement over the objection of the ERO. A preferable approach might be for the Commission to offer to mediate any

[237] NOPR at P 83.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

dispute over the terms of a delegation agreement between the ERO and a prospective Regional Entity.

Commission Conclusion

742. The Commission concludes that a prospective Regional Entity may submit a delegation agreement directly to the Commission if good faith negotiations with the ERO fail. The Commission strongly encourages the parties prior to this submission to consider the use of ADR[238] to resolve any disputes over the terms of the delegation agreement. Thus, a prospective Regional Entity that submits a delegation agreement directly to the Commission must state: (i) whether the Commission's Dispute Resolution Service (DRS) was used, or why the DRS was not used and (ii) whether the Regional Entity believes that ADR under the Commission's supervision could successfully resolve the disputes regarding the terms of the delegation agreement. We therefore affirm our statement in the NOPR that a Regional Entity applicant may apply to the Commission directly for authority to enforce Reliability Standards within a region if it is unable to reach agreement with the ERO within 180 days and can demonstrate that continued negotiations would not likely result in a delegation agreement within a reasonable period

[238] Alternative dispute resolution encompasses a variety of dispute resolution mechanism including mediation, early neutral evaluation and settlement judge procedures. It always involves the use of a third party neutral to help the parties find mutually acceptable solutions to their disputes. Unassisted negotiation between parties should not be confused with ADR. To discuss appropriate ADR options, the parties should contact the Dispute Resolution Service toll free at 1-877-337-2237 (local number: 202-502-8702), or by e-mail at: ferc.adr@ferc.gov.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

of time. The Commission will provide notice of such an application and an opportunity for all interested persons, including the ERO, to comment.

743. A minimum time for negotiations is necessary to prevent a prospective Regional Entity from merely going through the formality of seeking an ERO delegation before bypassing the ERO and asking the Commission to intervene. This practice would not be consistent with our intent to have a strong ERO. The Commission emphasizes that direct application to the Commission by a prospective Regional Entity should be considered an option only after other means for reaching agreement with the ERO have been exhausted. The Final Rule does not preclude mediation, but there is no need to impose such a requirement at this time. Mediation may be considered on a case-by-case basis. We disagree with APPA that the statute does not permit the Commission to direct the ERO to enter into the delegation agreement with the Regional Entity. Section 215(e)(4) permits the Commission to assign the ERO's authority to enforce Reliability Standards directly to a Regional Entity.

j. Performance Assessment of Regional Entities

744. Paragraph (f) of the proposed section on delegation required a Regional Entity approved by the Commission to periodically submit to the Commission an application to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

be approved as a Regional Entity.[239] The NOPR also sought comment on what would constitute a reasonable length of time for such periodic re-approval to be effective.[240]

Comments

745. Many commenters generally support a re-approval process for a Regional Entity. While several commenters support the Commission's suggestion of a five-year re-approval, others offer alternative suggestions on an appropriate time frame.

746. A number of commenters support a re-approval process for Regional Entities.[241] Cinergy argues that, absent such a requirement, the delegation approval process would be a one-time evaluation, after which the Regional Entity would lack accountability. SMUD suggests that the Commission should consider a periodic review of Regional Entities on a staggered basis to reduce the strain on ERO or Commission resources that could result from simultaneous reviews. Several commenters suggest that any Regional Entity re-approval process should follow the same timetable as ERO recertification.[242]

747. Commenters suggest several alternative time frames for review, varying from two to six years. Some commenters suggest regional delegation agreements should be subject

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[239] Id.

[240] Id. at P 84 (delegation question 10).

[241] See, e.g., Alcoa, Cinergy, NERC and SMUD.

[242] See, e.g., APPA, International Transmission, SERC, South Carolina E&G and TVA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

to review every six years.[243] A number of commenters suggest a five-year review cycle for a Regional Entity delegation agreement.[244]

748. APPA and EPSA recommend that the ERO should be involved in the review of a Regional Entity delegation agreement that is submitted to the Commission for re-approval by providing input on the merits of re-approval for each Regional Entity and submitting the delegation agreement for re-approval. Other commenters suggest that resubmission of the delegation agreement is unnecessary unless a change has taken place.[245]

749. Several commenters recommend requiring the Regional Entity to apply for re-approval in advance of the end of its term, with some commenters suggesting six months, and others a year in advance.[246] EPSA also suggests that a Regional Entity consult with the ERO in advance about its performance and need for changes in the delegation agreement and provide notice to the Commission one year before the end of its term. NERC advises that the Commission's approval should not expire automatically at the end of a term, but should continue until the Commission completes its periodic review of the Regional Entity performance and its delegation agreement.

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[243] See, e.g., APPA, NERC and TAPS.

[244] See, e.g., Alcoa, PSEG, SoCalEd, South Carolina E&G and TVA.

[245] See, e.g., Alcoa, PSEG and TVA.

[246] See, e.g., EPSA, PSEG, South Carolina E&G and TVA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

750. CEA and NERC suggest that the Commission coordinate with the appropriate regulatory authorities in Canada prior to denying re-approval of a Regional Entity. Any unilateral action taken by the Commission would be inconsistent with the goal of establishing a cooperative cross-border approach.

751. Numerous commenters argue that the Commission should not require a re-approval process.[247] SERC asserts that a requirement for periodic re-approval is not contained in the legislation and argues that a re-approval process would divert significant resources from a Regional Entity's primary purpose of proposing and enforcing Reliability Standards. Instead, a "decertification" process should be adopted that would be applied by the Commission at the request of the ERO if the Regional Entity fails to meets its requirements for remaining a Regional Entity.

752. FirstEnergy and FRCC argue that the Commission should decertify the ERO or a Regional Entity only as a last resort. FirstEnergy remarks that such an action "would be equivalent to the death penalty for the ERO or Regional Entity and would cause significant logistical problems" in transitioning to a new Regional Entity.[248]

753. ERCOT argues that instead of re-approval, the ERO should perform periodic audits of each Regional Entity, consistent with the Commission's proposal for the ERO.

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[247] See, e.g., ERCOT, FirstEnergy, FRCC, NPCC, NRECA, Ontario IESO, Progress Energy, SERC and Southern.

[248] FirstEnergy at 5.

Commission Conclusion

754. The Commission is persuaded by commenters that a Commission re-approval process could disrupt the work of the Regional Entities. The Commission does not adopt the proposed re-approval process as described in proposed section 38.7(f) of the NOPR. However, we adopt instead a periodic performance assessment process that requires a Regional Entity to affirmatively demonstrate to the ERO that it satisfies statutory criteria for the responsibilities it has been delegated. Section 39.3(c)(1)(iii) of the Final Rule requires that the ERO, as an element of the ERO performance assessment process, evaluate the effectiveness of each Regional Entity. The ERO must assess each Regional Entity's ability to develop and enforce Reliability Standards and provide for an adequate level of Bulk-Power System reliability. The ERO should explain how effectively each Regional Entity enforces Reliability Standards, providing statistical information on its investigations, findings and assessments of penalties. The ERO should also explain how each Regional Entity provides for fair and impartial procedures for enforcement of Reliability Standards and provides for openness, due process and balance of interests in developing Reliability Standards. The ERO's performance assessment of each Regional Entity must be presented to the Commission as part of the ERO's own periodic performance assessment filing.

755. As noted earlier in the ERO certification discussion, the Commission will allow for public comment on the ERO's performance assessment filing, including the performance assessment of each Regional Entity.~~and~~ In this proceeding, the Commission will issue an order finding that the ERO meets the statutory and regulatory criteria or

directing the ERO to comply or improve its compliance with the statutory and regulatory criteria for the ERO. This order will also include similar findings of compliance or directives to ensure that the Regional Entities comply or improve compliance with the statutory and regulatory criteria. Subsequently, if a Regional Entity fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order as discussed below under Enforcement of Commission Rules and Orders, including, if necessary and appropriate, a proceeding to consider rescission of approval of the Regional Entity's delegation agreement.

756. Outside of the periodic assessment process, any interested person who is dissatisfied with a Regional Entity's performance of its delegated functions may file a complaint with the ERO, concurrently informing the Commission of the complaint. If the ERO cannot resolve the complaint in a timely manner, the complainant may request that the Commission resolve the dispute.

9. Enforcement of Commission Rules and Orders – Section 39.9

757. Consistent with section 215(e)(5) of the FPA, the NOPR proposed that the Commission may take action as necessary and appropriate against the ERO or a Regional Entity "to ensure compliance with a reliability standard or any Commission order affecting the ERO or a Regional Entity." The NOPR proposed that, upon notice and opportunity for hearing, the Commission may suspend or rescind the ERO's certification or a Regional Entity's delegated authority. Further, the NOPR proposed that the Commission will periodically audit and review the ERO's and each Regional Entity's

compliance with the statutory and regulatory criteria for certification and delegation of functions.

a. Action against the ERO or a Regional Entity

758. The proposed regulations provided that the Commission may take such action as is necessary and appropriate against the ERO or a Regional Entity to ensure compliance with a Reliability Standard or any Commission order affecting the ERO or a Regional Entity.[249] Possible actions include the suspension or rescission of authority or the imposition of civil penalties under the FPA.

Comments

759. NRECA comments that Congress envisioned a cooperative, rather than a contentious, process and urges that the Commission, the ERO and Regional Entities work together to resolve any tensions that may emerge. APPA and LG&E Energy ask that the Final Rule identify specific causes for decertification.

760. Entergy states that the Commission should establish levels of ERO and Regional Entity non-compliance that would gradually lead to suspension or decertification since decertification as a first step would leave a large void and create unnecessary uncertainty for members of the organization. NERC suggests that, to prevent an unintended lapse in authority to set and enforce Reliability Standards, if the Commission decides to decertify the ERO, the ERO should remain in place until a successor is certified.

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[249] NOPR at P 74.

Commission Conclusion

761. While the Commission has the authority to take action against the ERO or a Regional Entity for non-compliance with section 215 of the FPA or rules or responsibilities thereunder, we would resort to assessing a monetary penalty only in extraordinary circumstances, and would consider decertification only as a last resort after all other attempts to resolve a significant compliance matter have failed. However, in a situation of deliberate non-compliance with a Commission order, we would not hesitate to impose an appropriate penalty.

762. The Commission would ensure that there is no gap in carrying out the requirements of section 215. The Commission would not permit any decertification to become effective until such time as the Commission itself, or another entity, were prepared to step in and implement the reliability functions of the decertified entity.

763. With regard to Entergy's comment, the Commission will determine the appropriate penalty for ERO or Regional Entity non-compliance on a case-by-case basis.[250] We do not establish here the levels of non-compliance suggested by Entergy.

764. The Commission is revising the text of the Final Rule to replace the phrase "rescission of the Commission's grant of certification to the Electric Reliability Organization," with the phrase "decertification of the Electric Reliability Organization." This revision will provide consistency in terminology throughout the Final Rule.

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[250] Enforcement of Statutes, Orders, Rules, and Regulations, 113 FERC ¶ 61,068 at P 17-20.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

765. Further, the proposed regulation, which tracks the statutory text, provides that the Commission may take such action as is necessary and appropriate against the ERO or a Regional Entity "to ensure compliance with a Reliability Standard …." Although, taken literally, this implies that the ERO or a Regional Entity may be in non-compliance with a Reliability Standard, this is not the correct interpretation because a Reliability Standard is applicable only to a user, owner, or operator of the Bulk-Power System, from which the ERO and each Regional Entity must maintain independence. This phrase means that the Commission can take appropriate action against the ERO or a Regional Entity when it has failed in its responsibility to assure that owners, users and operators of the Bulk-Power System are complying with a Reliability Standard. We also would take appropriate action, for example, if the ERO or a Regional Entity fails to comply with a Commission order requiring that a Reliability Standard be developed or modified as necessary to maintain reliability.

b. <u>Audits of ERO and Regional Entity Criteria</u>

766. The NOPR provided that the Commission would periodically audit and review the ERO's and Regional Entities' compliance with the statutory and regulatory criteria for certification and delegation of functions, respectively. The Commission requested comment on what mechanism of review and methods of oversight should be used to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

assure the Commission that the ERO or a Regional Entity is meeting its responsibilities for monitoring compliance with the Reliability Standards.[251]

767. Numerous commenters agree that the ERO and Regional Entities should be audited for compliance on a regular basis.[252] Santa Clara suggests that the Commission perform such audits at least annually to prevent inadequacies in the ERO's performance from going unaddressed for too long. ERCOT suggests that the Commission periodically audit the ERO with Regional Entity representatives on the audit team, and the ERO periodically audit Regional Entities with Commission staff represented on the audit team.

768. A number of commenters urge that independent auditors perform the enforcement audits. NERC and Southern recommend that independent enforcement audits of the ERO occur once every three years, and that the ERO should audit each Regional Entity at least once every three years and report the results to the Commission. The enforcement audit process used by the ERO to audit Regional Entities and the audit results should be included in the independent audit of the ERO.[253] The Missouri Commission suggests the creation of an independent, INPO-type entity to assess the performance of the ERO and

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[251] NOPR at P 76.

[252] See, e.g, APPA, CREPC, EEI, ELCON, ERCOT, FRCC, MRO, NERC, Santa Clara, Santee Cooper, Southern, TVA and Xcel Energy.

[253] MRO states that the Commission should rely on an independent assessment "similar to Statement of Auditing Standards No. 70 review," explaining that "The SAS No. 70 audit or service auditor's examination is widely recognized because it represents that a service organization has been through an in-depth audit of their control activities…." MRO at 25.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Regional Entities and believes that this approach provides more continuity and efficiency than Commission staff performing this function.

769. CREPC comments that the relevant Regional Advisory Body should be invited to participate in the periodic enforcement audit and review of the ERO and Regional Entities.

770. A number of commenters suggest additional mechanisms to ensure ERO and Regional Entity compliance. Ameren, APPA and NiSource suggest that the Commission monitor ERO and Regional Entity performance by requiring that they submit periodic reports. APPA also proposes the use of industry surveys to determine the effectiveness of the ERO and Regional Entities. PacifiCorp suggests that the required submission of annual working plans and budgets by the ERO and Regional Entities can be tools to assess effectiveness. Likewise, Ontario IESO recommends an annual performance filing by the ERO and each Regional Entity, including actual accomplishments relative to the annual workplans. Xcel Energy suggests that the Commission request performance metrics from the ERO and Regional Entities that demonstrate their ability to monitor compliance with Reliability Standards.

771. Ameren suggests that the Commission should maintain a hotline so that "internal and external employees" of the ERO or a Regional Entity can confidentially report failures by a reliability organization to adequately monitor behavior. FRCC states that the Commission has oversight based on its authority to respond to complaints that the ERO or a Regional Entity has violated a statutory or regulatory obligation. NiSource requests clarification on whether users, owners or operators of the Bulk-Power System

may petition the Commission, by complaint or some other method, to initiate an investigation into the activities of the ERO or a Regional Entity, and states that such right is crucial to ensure that the ERO and Regional Entities enforce Reliability Standards in a uniform, non-discriminatory manner.

Commission Conclusion

772. The Final Rule establishes that, in general, the Commission oversees the ERO and the ERO oversees any approved Regional Entity. Consistent with this approach, the Final Rule retains the substance of the NOPR's proposal that the Commission may periodically audit the ERO's performance of its functions.

773. We contemplate that a compliance audit of the ERO would typically involve an examination of the ERO's ongoing compliance with statutory and regulatory criteria for certification and its performance in carrying out its responsibility to oversee the compliance with and enforcement of Reliability Standards. The Commission, however, maintains the flexibility to determine the applicable scope of a particular audit. The Final Rule eliminates the proposed periodic Commission compliance audit of each Regional Entity. Instead, we require the ERO periodically to audit each Regional Entity's ongoing compliance with relevant statutory and regulatory criteria and performance in enforcing Reliability Standards and report the results to the Commission. A Commission audit of the ERO may include a review of the adequacy of the ERO's audits of Regional Entities. Moreover, the Commission retains the authority to participate in any ERO compliance audit of a Regional Entity or conduct its own compliance audit in response to particular circumstances that may warrant Commission participation or intervention.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

774. We point out that a Commission compliance audit of the ERO is not the same as the Commission's five-year performance assessment of the ERO, discussed above under Certification. The compliance audit is a means for the Commission frequently to ensure that the ERO is doing its job. The compliance audit examines the ERO's ongoing compliance with the statutory and regulatory criteria to qualify as an ERO and also its actual enforcement of Reliability Standards. The Commission would initiate a compliance audit, and the Commission will determine if the ERO is in compliance with the statutory and regulatory criteria or is somehow inadequate in enforcing Reliability Standards. The periodic performance assessment, on the other hand, is different. Although it will examine at a minimum the ERO's ongoing compliance with the statutory and regulatory criteria to qualify as an ERO, it will consist of a much broader examination of how well the ERO is carrying out all its responsibilities and how it may improve its performance of these responsibilities. These include not only the ERO's compliance investigations and penalty-setting responsibilities, but also its development of Reliability Standards, its ERO Rules and its relationships with the Regional Entities. While the compliance audit focuses on examining any deficiencies in ERO compliance, especially for investigations and penalty setting, the performance assessment is intended to examine opportunities for the ERO to improve. Further, the performance assessment is initiated when the ERO files with the Commission an assessment of its own performance in these areas, and is followed by a Commission examination of this performance assessment, with opportunity for public comment.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

775. The Commission does not decide in the Final Rule the appropriate audit cycle or the need for independent auditors but will exercise its discretion to set or revise its audit program or policies as necessary.

776. Given that no Regional Advisory Body exists today, it is premature for us to address, as suggested by CREPC, whether a relevant Regional Advisory Body should be allowed to participate in Commission compliance audits.

777. A number of commenters suggest various reporting requirements to enhance our oversight of the ERO. As discussed in different sections of the Final Rule, the Commission requires the ERO to report to the Commission on various aspects of its operations, including an annual budget and business plan,[254] reliability assessments, and penalties imposed.

778. With regard to NiSource's requested clarification, third parties would have the opportunity to petition the Commission to initiate an investigation either formally through the filing of a complaint, as suggested by FRCC, or informally by contacting the Commission's Enforcement Hotline, as suggested by Ameren. The Enforcement Hotline provides a confidential means for a market participant, or an employee of a reliability organization, to bring to the Commission allegations that the ERO or a Regional Entity has not fulfilled its statutory, regulatory or delegated responsibilities. While third parties have the opportunity to bring a compliance matter to the Commission's attention, they do

[254] See 18 CFR 39.4 (Funding of the Electric Reliability Organization).

not have a right to initiate a Commission investigation, as suggested by NiSource. Rather, the Commission retains prosecutorial discretion to decide whether to pursue a particular matter.

c. Monetary Penalties

779. In the NOPR, the Commission asked whether the ERO or a Regional Entity should be able to recover any monetary penalties levied directly by the Commission against the ERO or a Regional Entity for violation of section 215 of the FPA, or any Commission regulation or order, through dues, fees, or other charges.[255]

Comments

780. Numerous commenters oppose the assessment of a monetary penalty against the ERO or a Regional Entity.[256] They claim that, because the ERO and any Regional Entity will be not-for-profit entities that must pass through costs, subjecting them to penalties would really penalize the end users that would ultimately bear the costs. Further, given the other tools available to the Commission, including decertification, commenters argue that it should be unnecessary to resort to monetary penalties to bring the ERO into compliance. TAPS suggests that the Commission should delete the reference to civil penalties.

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[255] NOPR at P 77.

[256] See, e.g., Alberta, APPA, CEA, Entergy, Exelon, Hydro-Québec, NERC, New York Companies, Ohio Commission, PG&E, PSNM-TNPC, TAPS and TVA.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

781. Some commenters question the Commission's legal authority to impose penalties against the ERO or Regional Entities.[257] NRECA comments that, while the NOPR tracks section 215(e)(5) of the FPA, the Commission's authority to impose penalties in section 215(e)(3) is limited to users, owners or operators of the Bulk-Power System and does not include the ERO or a Regional Entity. NRECA cautions that, consistent with the axiom that penalties be strictly construed, the Commission should proceed with judicious restraint in this area.

782. AEP and others respond that, as a not-for-profit entity, the ERO or a Regional Entity would have no alternative but to seek recovery from those that are responsible for its funding. Allegheny states that, in the unlikely case that the ERO or a Regional Entity is a for-profit organization that is allowed to recover a return on investment, the entity should bear the risk of such penalties as part of its incentive to earn a reasonable return. ELCON comments that the ERO or a Regional Entity should not be allowed to recover a penalty through dues, fees or other charges because allowing the recovery of costs negates the penalty. It states that the only meaningful penalty is the risk of decertification or bankruptcy.

783. CEA, Hydro-Québec and Ontario IESO explain that the imposition of a penalty against the international ERO or a Cross-Border Regional Entity would have extra-jurisdictional implications. For example, a monetary penalty imposed by the

[257] See, e.g., CEA, Progress Energy, SERC, Southern, and TAPS.

Commission on a Cross-Border Regional Entity would be paid in part by one or more Canadian utilities and, accordingly, Canadian ratepayers. CEA states that it would be inappropriate for the Commission to assess a penalty that would be borne by entities that are not Commission-jurisdictional.

784. EEI submits that, while the Commission may impose a monetary penalty on the ERO or a Regional Entity, it should do so only as a drastic action. According to EEI, if a monetary penalty is imposed, the ERO or Regional Entity should apply for cost recovery with the Commission. EEI states that, in light of the likely organizational structures of the ERO and Regional Entities, it is difficult to envision how penalties would not ultimately be passed through to the end users.

Commission Conclusion

785. The Commission believes that, in most circumstances, compliance audits, compliance plans and additional reporting requirements, with the ultimate possibility of decertification, should be effective in ensuring ERO and Regional Entity compliance with statutory and regulatory criteria as well as applicable Commission orders. The Final Rule allows the Commission to impose a civil penalty on the ERO or a Regional Entity and permits its recovery from those responsible for funding the ERO or Regional Entity, although, as discussed previously, we would expect to use this provision only in extraordinary circumstances.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

786. The Commission has the legal authority to impose a civil penalty pursuant to section 316A of the FPA, which applies to a violation of any provision under Part II of the FPA, including section 215.[258] We disagree with the assertion of NRECA and others that the Commission's ability to take action against the ERO or a Regional Entity is limited by section 215(e)(3). That provision, which relates to Commission action against a user, owner or operator of the Bulk-Power System, is not relevant to our authority vis-à-vis the ERO or a Regional Entity.

d. Penalizing an ERO or a Regional Entity Board Member

787. Most commenters object to assessing a monetary penalty against a board member personally. They allege that this would have a chilling effect upon recruitment and retention of high quality board members as well as the resulting increase in insurance costs.[259] NERC points out that the ERO's directors cannot profit monetarily when carrying out their duties since they cannot have any financial or other interest in any user, owner or operator of the Bulk-Power System, or otherwise gain financially from the actions of the ERO or a Regional Entity.

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[258] Section 316A provides that a person who violates any provision of Part II of the FPA, or any related rule or order, shall be subject to a civil penalty of not more than $1,000,000 for each day that such violation continues. Section 316A would apply to the extent that the ERO or a Regional Entity is in violation of section 215 or any other provision of Part II of the FPA or any rule or order issued under any provision of Part II.

[259] See, e.g., Ameren, ELCON, EPSA, ISO/RTO Council, MidAmerican, Missouri Commission, NERC, Northern Maine Entities, Ontario IESO, PacifiCorp and WECC.

788. The Missouri Commission questions the Commission's authority to assess a monetary penalty against a board member. It suggests, as a better approach, putting in place an incentive package for both board members and managers that would include both rewards and penalties. PacifiCorp suggests that other laws, regulations and corporate bylaws could address inappropriate actions by the ERO or Regional Entity board members.

789. EEI contends that a monetary penalty should not be imposed on a board member except perhaps in the case of proven gross negligence or other extraordinary circumstances. EEI and TVA recommend the use of non-monetary penalties, such as removal from the board. Likewise, ERCOT and FRCC believe that penalizing a board member is inappropriate except in rare circumstances such as when a board member acts for his own pecuniary gain at the expense of legitimate reliability interests or when a board member has repeatedly and intentionally supported the violation of Reliability Standards.

Commission Conclusion

790. The Commission agrees that assessing monetary penalties against ERO and Regional Entity board members would have a chilling effect on the recruitment and retention of highly qualified board members. Moreover, a board member of a not-for-profit ERO or Regional Entity would not have the opportunity to derive pecuniary gain from his or her position. Other forms of penalty, such as removal of a board member for good cause, are more appropriate. Accordingly, section 39.9 of the Final Rule does not provide for the assessment of a monetary penalty against a board member of the ERO or

a Regional Entity. The Missouri Commission comment regarding the Commission's authority to do so therefore need not be addressed.

10. Changes in Electric Reliability Organization Rules and Regional Entity Rules - Section 39.10

791. The NOPR proposed that the ERO shall file with the Commission for approval of any proposed ERO Rule or changes to an ERO Rule, accompanied by an explanation of its basis and purpose. It also proposed that a Regional Entity shall submit a Regional Entity Rule or changes to Regional Entity Rule to the ERO and, upon approval by the ERO, the ERO shall file with the Commission for approval any proposed Regional Entity Rule or changes to a Regional Entity Rule accompanied by an explanation of its basis and purpose. Paragraph (b) of the proposed regulations on ERO and Regional Entity Rules provides that the Commission, upon its own motion or complaint, may propose changes to the Rules of the ERO or a Regional Entity.

792. The NOPR also stated that a proposed ERO Rule, Regional Entity Rule, or changes to those Rules shall take effect upon a finding by the Commission, after notice and opportunity for comment, that the change is just, reasonable, not unduly discriminatory or preferential, is in the public interest, and satisfies the certification requirements in the regulations.

Comments

793. MRO opposes Commission review of Regional Entity Rules and changes to Regional Entity Rules. It states that section 215(f) of the FPA provides for review of ERO Rules and changes to ERO Rules by the Commission, but the Commission has

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

expanded its reach to include review of Regional Entity Rules and changes to Regional Entity Rules. It asserts that such interpretation is inconsistent with the statute and unnecessary. It asks the Commission to revise this section to exclude review of Regional Entity Rules and changes to Regional Entity Rules.

794. On the other hand, the Oklahoma Commission requests that the Commission consider streamlining the Rule modification process by allowing a Regional Entity to submit a proposed Rule modification directly to the Commission, with simultaneous service of the proposed modification to the ERO. The ERO could then comment along with other interested parties and the Commission could make its decision accordingly. Such a process would cut out unnecessary expense and delay. The Oklahoma Commission claims that this approach would further Congress's intent to provide for the reliable operation of the Bulk-Power System.

795. In addition, the Oklahoma Commission contends that the proposed section is silent on many important aspects of the review such as: (1) what objective criteria will be used by the ERO when considering a proposed modification; (2) what is the timeline under which the ERO must make a decision; (3) whether the ERO is required to send a disapproved modification back to a Regional Entity for further study or modification; and (4) whether the ERO's Rule modification decision will be subject to appeal to or review by the Commission. According to the Oklahoma Commission, while the ERO and the Commission must have some flexibility when considering Rule modifications, any proponent of a proposed modification will, at a minimum, need to understand the process and standards against which the proposed modification will be judged.

Commission Conclusion

796. We adopt in section 39.10 the substantive provisions of the proposed regulation. Our authority to review Regional Entity Rules and changes to Regional Entity Rules after they have been approved by the ERO follows from section 215(e)(4) of the FPA and is consistent with Congress's intent and the overall framework of section 215. Section 215(e)(4) explicitly requires that the Commission shall issue regulations authorizing the ERO to enter into an agreement to delegate authority to a Regional Entity if it meets certain conditions.

797. Although we do not adopt the Oklahoma Commission's suggestion that a Regional Entity directly submit the Regional Entity Rules or changes to Regional Entity Rules to the Commission because such a process would not be compatible with the ERO's authority to enforce its delegation agreement and its responsibility to ensure that such changes further the goals of the statute, we agree with the Oklahoma Commission that the Regional Entity should have a clear understanding of the process and criteria by which the Regional Entity Rules or changes to Regional Entity Rules will be judged by the ERO. Accordingly, the ERO should develop such procedures and criteria and submit these to the Commission for approval.

11. Reliability Reports – Section 39.11

798. The NOPR provided that the ERO shall conduct periodic assessments of the reliability and adequacy of the Bulk-Power System and report its findings to the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission, the Secretary of Energy, Regional Entities, and any Regional Advisory Bodies annually, or more frequently if directed by the Commission.[260] Commenters address the required frequency of such reports, the scope and content of these reports, and whether they should be noticed and made available to the public.

Comments

799. MRO submits that, if the Commission were to require quarterly reporting, this obligation would be unnecessarily burdensome, and possibly redundant, given the other reporting obligations proposed in the NOPR. MRO recommends that the Commission require the ERO to provide an annual report assessing the reliability and adequacy of the Bulk-Power System.

800. PG&E submits that the regulations should additionally require that the ERO, at least on a yearly basis, obtain specific information on the contribution of all entities, including entities referenced in section 201(f) of the FPA, toward adequacy, including the amount of capacity and energy that such entities have under contract, and further require that the ERO make recommendations where entities have inadequate resources. PG&E notes that the ERO will be uniquely situated to evaluate adequacy, as the adequacy of generation and transmission resources on which reliability depends are governed by a wide array of federal, state and local jurisdictions within and between regions and control areas. In PG&E's view, only a uniform evaluation of readiness of the resources within

[260] NOPR at P 95.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

these various jurisdictions can meaningfully reveal the extent to which the Bulk-Power System can be relied upon in both the near-term and long-term. Moreover, only an entity with broad authority to conduct such inquiries can reveal whether the burden of achieving adequacy is being equitably distributed or whether entities are "free-riding." PG&E further asserts that, otherwise, the proposed regulation does not properly implement the Congressional intent manifest in the interplay of the requirements of sections 215(g) and (i)(2) of the FPA.[261] PG&E recommends that the ERO must be empowered to provide timely alerts to the Commission, all other jurisdictional entities responsible for adequacy, and the Congress.

801. Hydro One notes that, currently, the regional reliability councils play an important role in coordination of the conduct of periodic assessments of the reliability and adequacy of the Bulk-Power System within a region. It asks that the Commission ensure that the Regional Entities continue this important coordination function.

802. NASUCA suggests that the Final Rule should provide that all reliability and adequacy reports filed pursuant to the regulation on reliability reports be made available to the public. PG&E submits that the ERO's reliability and adequacy reports, including those regarding section 201(f) entities, should be publicly noticed and made available to the public, while respecting confidentiality and competitiveness concerns, because the

[261] While section 215(g) of the FPA pertains to ERO reporting on reliability and adequacy, section 215(i)(2) of the FPA notes that section 215 does not authorize either the Commission or the ERO to order construction of additional generation or transmission capacity or set and enforce compliance with standards for adequacy.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

resulting public pressure would assist in convincing such entities to supplement their resource procurement programs.

Commission Conclusion

803. The Final Rule requires the ERO to provide to the Commission two types of periodic reliability reports. First, the ERO must conduct reliability assessments and report its findings to the Commission regarding the overall state of the Reliable Operation of the Bulk-Power System. Second, the ERO must conduct assessments of the adequacy of the Bulk-Power System and report its findings to the Commission, the Secretary of Energy, each Regional Entity and each Regional Advisory Body.

804. Section 39.11(b) provides the Commission discretion to require that the ERO submit an adequacy assessment report more frequently than annually. We appreciate MRO's concern about over-taxing the resources of the ERO and Regional Entities with multiple or frequent reporting requirements. The Commission sees no need, however, to limit its discretion in this area at this time. The Commission will balance the need for timely information regarding system reliability and adequacy with the burden on the ERO's resources whenever we consider having the ERO provide reports more frequently than annually.

805. With respect to the concerns about the scope and content of the reliability and adequacy assessments prepared by the ERO, the Commission expects each assessment to be comprehensive in order for the Commission, the ERO, and the Regional Entities to fulfill their respective oversight responsibilities. As will be established in later proceedings, we would expect that such assessments could include, for example,

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

operating and planning reports, reports of ongoing activities such as readiness audits, seasonal reliability assessments, as well as relevant recommendations. In addition, the Commission may determine that reliability and adequacy assessments should include appropriate metrics, if applicable, to assist the Commission in monitoring actual reliability performance and plans.

806. We agree with PG&E's recommendation that the Commission require the ERO to obtain information on resource adequacy and make related recommendations where entities are found to have inadequate resources. Resource adequacy is a fundamental aspect of reliability. The ERO is in a unique position to obtain and analyze information regarding resource adequacy across all regions of the Bulk-Power System in interconnected North America. Although section 215(a)(3) of the FPA provides that the term Reliability Standard does not include any requirement to enlarge Bulk-Power System facilities or to construct new transmission capacity or generation capacity, it does not preclude the ERO from obtaining information relating to resource adequacy for the purposes of making its required reports on the adequacy of the Bulk-Power System pursuant to section 215(g) of the FPA. Accordingly, section 39.11(b) of the Final Rule sets forth a separate requirement that the ERO conduct assessments of the adequacy of the Bulk-Power System in North America and report its findings to the Commission and others. Further, the ERO may obtain pertinent information on resource adequacy from any relevant user, owner or operator of the Bulk-Power System.

807. We agree with commenters on the need for notice and public availability of reliability and adequacy assessments. Accordingly, reliability and adequacy assessments

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

reports filed at the Commission will be made public unless the Commission deems it necessary and lawful not to do so or unless the ERO requests confidential treatment pursuant to our rules and regulations.

12. Inconsistency of a State Action and a Reliability Standard – Section 39.12

808. Consistent with section 215(i)(3) of the FPA, the proposed rule provided that nothing in the regulation shall be construed to preempt any authority of any state to take action to ensure the safety, adequacy, and reliability of electric service within that state, as long as such action is not inconsistent with any Reliability Standard. The NOPR also proposed that where a state takes action, the ERO, a Regional Entity, or any other party may ask the Commission to determine whether such state action is inconsistent with a Reliability Standard. The Commission would then provide notice and opportunity for hearing, take into consideration any recommendation of the ERO, and issue a final order on the matter within 90 days. It further provided that the Commission may stay the effectiveness of the state action until it issues the final order.

809. Comments on this section cover three topics: the general balance of authority between the Commission and the states, recommendations regarding Commission procedures for reviewing the inconsistency of a state action with a Reliability Standard, and the concerns of specific states.

a. General Balance of Authority

810. A number of commenters discuss the longstanding and legitimate role of states in overseeing Bulk-Power System reliability.[262] They argue that the Commission should give great deference to state regulators and use its preemption power sparingly. Commenters recognize the interconnected, interstate nature of the Bulk-Power System, and argue that existing state authority to protect reliability should be preserved and should complement the new Commission authority to enforce Reliability Standards for the Bulk-Power System. For example, the Florida Commission expresses concern that the Final Rule could diminish a state authority's ability to assure safe, adequate, reliable, and efficient operation of a local electric grid. Some commenters further assert that EPAct limits the Commission's preemption power to those issues clearly outside the jurisdiction of the states.[263]

811. Regarding state requirements for generation and transmission planning and adequacy, NASUCA, Missouri Commission and others point out that the statute gives the ERO authority to develop and enforce compliance with Reliability Standards for only the Bulk-Power System; it also denies the ERO and the Commission authority to order the construction of additional generation or transmission capacity, or to set and enforce compliance with standards for adequacy or safety of electric facilities or services. The

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[262] See, e.g., NARUC, NPCC, NASUCA, LADWP, PacifiCorp, and Missouri Commission.

[263] See, e.g., NASUCA and Missouri Commission.

Missouri Commission and others ask the Commission to respect the states' planning and resource adequacy authorities or to clarify the ERO's and the states' roles regarding generation and transmission planning standards in the Final Rule.

812. State commenters argue that NERC and regional reliability council reliability rules developed previously for voluntary use were not intended to replace or limit other approaches to promoting reliability, and contend that making these mandatory Reliability Standards should not have this unintended effect.

Commission Conclusion

813. The Commission recognizes the important role that state governments have in regulating many aspects of electric reliability, especially ensuring that state franchised utilities meet their obligation to construct enough capacity to ensure that they remain able to provide the public with reliable electric service. We recognize that states have important reliability responsibilities and these generally include, and are not necessarily limited to, requiring franchise utilities to make adequate investment in new generation, distribution, and transmission infrastructure, and in many cases to develop adequate demand response as needed to help keep generation and load in balance. We do not, however, agree with the characterization made by some commenters that section 215 of the FPA restricts a Reliability Standard to addressing an issue clearly outside the jurisdiction of a state. Instead, section 215 generally permits a state to take action that addresses the safety, adequacy and reliability of electric service within the state, as long as such action is not inconsistent with a Reliability Standard. We intend to respect these important state government functions, and we agree with commenters that state

authorities and our new authorities should be complementary and work in unison to ensure reliable electric service for our nation's electricity customers.

814. Regarding the Missouri Commission's request that we clarify the ERO and state roles regarding generation and transmission planning standards in particular, we do not believe it is possible or desirable to try to develop generic guidelines on planning roles in this proceeding. If the ERO proposes a Reliability Standard, whether on planning or any other topic, we will consider carefully at the time when a specific Reliability Standard is before us whether it falls within the ERO's and the Commission's statutory area of responsibility. We emphasize that we intend to continue to respect states' roles in these areas. Indeed, the Commission has devoted considerable time and attention in recent years, through its orders and its many regional infrastructure conferences, to encouraging states and others to develop plans for ensuring adequate electric generation, transmission, and demand response infrastructure for both reliability and market adequacy.

815. The statute explicitly bars preemption of any authority of any state to take action to ensure the safety, adequacy and reliability of electric service within the state, as long as such action is not inconsistent with a Reliability Standard. The Commission anticipates that conflicts between a state requirement and a Reliability Standard will be rare, if any occur at all. We expect that any potential conflict between a proposed Reliability Standard and an existing state requirement will be resolved as the Reliability Standard is developed, and parties may raise any such conflict before the Commission when a proposed Reliability Standard is submitted to us for approval. Similarly, if a state agency is considering an action that could possibly conflict with a Reliability Standard

already in effect; we expect that parties will bring this to the attention of the state agency for resolution. If, however, such an inconsistency should occur, the statute and our regulations provide a criterion and a procedure for resolving the conflict.

b. Review of Allegedly Inconsistent State Actions

816. Several commenters, especially state commissions, urge the Commission to consider state agency expertise and give as much weight to the input of state authorities as it does to the input of the ERO when reviewing a state action.[264] Several make specific recommendations.

817. The Kentucky PSC and the Oklahoma Commission request that the Final Rule resolve an apparent inconsistency between proposed subsections (b) and (c) of the state action regulations. According to subsection (c), the Commission would consult with both the ERO and the state taking an allegedly inconsistent action before staying the state's action. However, subsection (b)(2) provides explicitly that the Commission decision would take into consideration the recommendation of the ERO, without explicitly mentioning the recommendation of the state. Either (b)(2) should be revised to read like (c), they request, or both should be revised to allow all parties to make recommendations.

818. The Oklahoma Commission argues that the state agency must have unfettered access to any proceeding that affects its authority because its jurisdictional responsibilities are at issue. It advises the Commission that this can be accomplished by

[264] See, e.g., Kentucky PSC, Oklahoma Commission, Florida Commission, and LADWP.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

requiring that notice be given to the affected state agency simultaneously with the filing with the Commission of a request to review a state action. Given the short 90-day window within which the Commission must by law issue a final order on any alleged inconsistency, the Oklahoma Commission claims that due process dictates that the relevant state agency be involved from the outset.

819. The Florida Commission believes that the Commission should not allow parties to seek a stay of a proposed state action while the state is still considering whether to undertake the action. It advocates that the Final Rule make clear that parties to a state proceeding should be required to wait until the final state action before Commission review is granted.

820. LADWP asks the Commission not to interpret "inconsistent" in a way that would preclude a state from taking action to make its system more reliable.

Commission Conclusion

821. The Commission agrees with commenters that the proposed rule may appear ambiguous regarding whether the Commission would consider the recommendation of the relevant state as well as the ERO when deciding an issue regarding an alleged inconsistency. Accordingly, section 39.12(b)(2) of the Final Rule provides that the Commission will take into consideration the recommendations of both the ERO and the state. We will also, of course, consider the views of all parties that file comments on the matter.

822. As the Oklahoma Commission requests, we have added a new requirement in section 39.12(b)(1) of the Final Rule that a petition for determination of inconsistency be

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

served on the relevant state agency, concurrent with filing with the Commission and the ERO.

823. We will reserve judgment on the Florida Commission's recommendation that a state action must be final before an alleged inconsistency is referred to the Commission. We generally expect parties to delay a filing with the Commission until state action is final, but we will not mandate such a requirement at this time.

824. LADWP asks about the authority of a state to require greater reliability than a Reliability Standard. Although we cannot speak definitively on the inconsistency of a state action and a Reliability Standard when neither is before us, in general a state action that simply sets an additional, and not a substitute, reliability requirement, or that provides for a more stringent reliability requirement than a Reliability Standard, and is not otherwise inconsistent with any Reliability Standard should not be precluded under this Final Rule.

c. <u>Concerns of Specific States</u>

825. Some commenters ask the Commission to take into account the special circumstances of particular states. The City of San Antonio recommends that the Commission defer to ERCOT and the Texas Commission to determine whether a state action in ERCOT is consistent with a Reliability Standard because the expertise to review the inconsistency between an ERCOT market rule or other rule and a Reliability Standard resides within ERCOT—and the Texas Commission has the authority to modify those market rules, if required.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

826. FRCC asserts that the reliability policies and practices for the Florida peninsula should be addressed at the state, not federal, level because of the peninsular geography, electric grid characteristics, and the tropical climate and severe weather of the area. FRCC foresees that the "Regional Entity established for peninsular Florida" will use the state action provision in the Act to address reliability issues unique to Florida."[265] FRCC argues that Congress understood this need for local consideration of reliability issues when it drafted the provision that allows a state action that is not inconsistent with any Reliability Standard.

827. For the State of New York, section 215(i)(3) of the FPA provides an exception to the rule by which the Commission must review the inconsistency of a state action with a Reliability Standard; however, the text of the proposed regulation does not explicitly state this exception. NERC recommends that the proposed rule be modified to reflect this special provision for reliability actions by the State of New York. In contrast, New York ISO interprets the absence of a reference to New York in our proposed rule as an appropriate recognition that this FPA provision for New York state reliability rules is outside the scope of this rulemaking.

Commission Conclusion

828. Section 215(i) of the FPA authorizes the Commission to determine whether a state action is inconsistent with a Reliability Standard. Congress applied this provision to the

[265] FRCC at 3

United States, except Alaska and Hawaii, and provided a limited exception for the State of New York.

829. The provision applies in the ERCOT region of Texas and the peninsular region of Florida. However, the parties in these regions should have ample opportunity to avoid a potential conflict between a Reliability Standard and any other requirements established by the states of Florida or Texas, by the FRCC or ERCOT as possible future Regional Entities under the statute, or by ERCOT as a market-facilitating ISO created under Texas law. As discussed above, those parties developing, commenting on, and voting on a newly proposed Reliability Standard will be from all regions of the United States and other countries. They will have to consider how to make the proposed Reliability Standard suitable for all regions with different market structures and designs, as well as different geography, differences in severe weather threats, and grid characteristics. If the ERO does not resolve these concerns, parties are free to bring them to the Commission when a proposed Reliability Standard is filed with us for approval.

830. Further, as discussed more fully elsewhere in this order, the statute and our regulations provide for Regional Entities and, where appropriate, regional differences in Reliability Standards to meet the unique needs of each region. ERCOT and FRCC indicate that they intend to seek approval as Regional Entities and will have the opportunity to propose needed regional differences. Also, as discussed elsewhere in this order, a Regional Entity may undertake to develop reliability activities outside the scope of the FPA and may seek to have state enforcement of any reliability requirements that are not jurisdictional to the Commission. We note further that the existing ERCOT

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

regional reliability council is organized on an interconnection-wide basis, and the Commission will give due weight to the technical expertise of a Regional Entity organized on such a basis regarding a proposed Reliability Standard to be applicable in that interconnection, as required by statute. Further, the statute and our regulations provide for Regional Advisory Bodies to advise the Commission and the ERO on special regional needs. The Commission intends to take such advice seriously.

831. With all these opportunities to avoid inconsistency between a state action and a Reliability Standard, we expect that applications to the Commission regarding alleged inconsistencies will be rare. Should such an application be filed, however, the Commission cannot delegate its responsibilities. The Commission will follow the process set out in the statute. We will determine, after consulting with both the state and the ERO, if there is an inconsistency between a Reliability Standard and any state's action, including an alleged inconsistency between a Reliability Standard applicable in ERCOT and an action by the State of Texas or between a Reliability Standard applicable in FRCC and an action by the State of Florida.

832. City of San Antonio is concerned about who should resolve any inconsistency between an ERO or ERCOT Reliability Standard and an ERCOT market rule, stating that the Texas Commission has the expertise to resolve any market design issues. However, it is up to the Commission under the FPA to determine if there is such an inconsistency. If there is, the Reliability Standard is controlling under the statute.

833. Finally, we agree with NERC regarding the New York exception and revise the regulations in the Final Rule to state it explicitly. It is inappropriate to interpret this

omission from the NOPR as indicating that this provision is outside the scope of this rulemaking. The statute provides that the Commission must review any alleged inconsistency presented to us between a state action—including a New York action—and an ERO or Regional Entity Reliability Standard "except that the State of New York may establish rules that result in greater reliability within that State, as long as such action does not result in lesser reliability outside the State than that provided by the reliability standards." Although the standard of review for inconsistency is different for New York, the jurisdiction of the Commission to conduct the review is the same, and it is an appropriate subject for this rulemaking.

13. Regional Advisory Bodies – Section 39.13

834. Consistent with section 215(j) of the FPA, proposed regulations provided that the Commission shall consider a petition to establish a Regional Advisory Body that is submitted by at least two-thirds of the states within a region that have more than one-half of their electric load served within the region.

835. The NOPR proposed that a Regional Advisory Body may provide advice to the Commission, the ERO, or a Regional Entity with respect to the governance of an existing or proposed Regional Entity within its region; whether a Reliability Standard proposed to apply within the region is just, reasonable, not unduly discriminatory or preferential, and in the public interest; whether fees for all activities under section 215 of the FPA proposed to be assessed within the region are just, reasonable, not unduly discriminatory or preferential, and in the public interest; and any other responsibilities requested by the Commission. The NOPR further proposed that the Commission may give deference to

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

the advice of any such Regional Advisory Body if it is organized on an Interconnection-wide basis.

836. In addition, the Commission sought comment on the scope of the term "region" as used in proposed section on Regional Advisory Bodies. In particular, the NOPR asked whether the region represented by a Regional Advisory Body should correspond to that of an existing or proposed Regional Entity.

Comments

837. NARUC agrees that the proposed regulations accurately track the statutory provision with respect to the composition of a Regional Advisory Body, the subject matter on which it is to provide advice, and the Commission's deference to the advice of a Regional Advisory Body organized on an Interconnection-wide basis. According to NARUC, the regulations should be adopted as proposed because they simply provide procedural instructions to accomplish the statutory objective.

838. According to SoCalEd and the Ohio Commission, the formation of the Regional Advisory Body should follow the establishment of an ERO and Regional Entities because the establishment of an ERO and Regional Entities is important to implement the Reliability Standards whereas a Regional Advisory Body will simply perform an advisory task.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

839. With respect to the scope of the term "region," several commenters[266] assert that the region represented by a Regional Advisory Body should correspond to that of a Regional Entity. However, many other commenters[267] recommend flexibility in the geographic coverage of Regional Advisory Body because Regional Entities are yet to be formed.

840. NPCC believes that if the footprint of a Regional Advisory Body coincides with that of a Regional Entity, it will result in greater efficiency and cooperation with state and provincial governments. ELCON adds that if a Regional Entity later changes its geographical scope and configuration, the Regional Advisory Body should also change to match the new scope and configuration. NERC asserts that, to avoid overlapping or conflicting advice, the ERO will be best served by a Regional Advisory Body corresponding to the area covered by a Regional Entity. PSEG claims that a Regional Advisory Body that does not correspond to the area covered by Regional Entity would not only be inefficient but also cause confusion and conflicts. Southern contends that the region represented by a Regional Advisory Body should correspond to that of the existing Regional Reliability Council.

841. MRO, on the other hand, contends that the region represented by a Regional Advisory Body should not necessarily have to correspond to the region of a Regional

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[266] See, e.g., AEP, Ameren, CPUC, ELCON, NPCC, PSEG and TVA.

[267] See, e.g., APPA, MRO, Progress Energy and Santee Cooper.

Entity because doing so will create unnecessary redundancy. For example, organizations such as MRO, which intend to be a Regional Entity, already have processes in place for state and provincial regulatory participation. According to MRO, a Regional Advisory Body will be more effective at the ERO level, as compared to the Regional Entity level, in providing advice on overall policy matters. However, it also supports Regional Advisory Body organized on an Interconnection-wide basis.

842. APPA contends that the Commission should, at least initially, allow flexibility in the geographic coverage of a Regional Advisory Body. The Commission, however, should ensure that the representation on the Regional Advisory Body is broadly inclusive of all entities in the state that must comply with the ERO's Reliability Standards.

843. Progress Energy and Santee Cooper contend that the Commission should provide some latitude in what constitutes a region, but certain guidelines could be applied (e.g., the boundaries of a Regional Entity).

844. NARUC states that there is obvious symmetry and convenience if a Regional Advisory Body corresponds to the area covered by a Regional Entity. Yet, there are some valid reasons why this may not always be practical. One such situation would involve the possible consolidation of Regional Entities in the Midwest. States may be able to realign Regional Advisory Bodies, but that process may take some time. Another issue that could deter ideal alignment is the "two-thirds" and "one-half" conditions. These conditions may influence which states are included as members of a Regional Advisory Body, even though adjoining states may have significant interest in actions of the related Regional Entity. A third alignment issue may relate to Regional State

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Committees based on the footprints of RTOs. For these reasons, the NARUC urges the Commission to understand that a Regional Advisory Body may sometimes not correspond exactly with a Regional Entity and contends that the Commission's reliability goal will be better facilitated by encouraging the states' regional cooperation in self-designated regions than by prescriptive attempts to define regions in ways that may not reflect all relevant considerations.

845. NARUC notes that section 215(j) of the FPA allows the Commission discretion in giving deference to the advice given by a Regional Advisory Body that is organized on an Interconnection-wide basis. It states that the Commission's exercise of discretion in granting such deference should depend upon the type of advice being given by a Regional Advisory Body and issues surrounding it. Therefore, the Commission should not specify a greater precision in the degree of deference it would grant to such advice.

846. NARUC states that, while there is no need to address such situations before they arise, the Commission should give appropriate consideration to advice offered by states or group of states in the following three situations: A group of states may offer advice on a reliability issue without seeking formal recognition as a Regional Advisory Body. Also, a recognized Regional Advisory Body may offer advice that is outside the scope of its legislative responsibilities. Further, bodies such as those organized to coordinate state RTO activities may offer advice on reliability issues.

847. The Nova Scotia Board points out that, although the Commission might give deference to the advice received from a Regional Advisory Body, there is no such requirement for the Canadian regulator.

848. The Ohio Commission states that a Regional Advisory Body is a body of states and that the states will form these Regional Advisory Bodies as they see fit. It questions the requirement that a Regional Advisory Body must have two-thirds of the states within a "region" and the "region" should have more than one-half of the state's load within the "region." However, if the Commission adopts these requirements -- two-thirds and one-half – in the Final Rule, special circumstances must be recognized. If a state is in more than one Regional Entity, careful scrutiny and special consideration must be given to adequately represent that state's interest. According to the Ohio Commission, the Commission must consider the following questions before adopting the requirements for a Regional Advisory Body: (1) Will the states have equal representation? (2) Will states in larger Regional Entities have less representation than states in smaller Regional Entities? (3) Do all Regional Entities (small and large) have the same amount of voting power? (4) What about states with greater generation, transmission and load than others and some consideration should be given to load weighting if their ratepayers bear the greater burden?

849. According to the Missouri Commission and the Ohio Commission, a Regional Advisory Body should not be limited to states that have more than one-half of their electric load served within the region. The Missouri Commission claims that neither the law nor the proposed regulations limit the participation of an individual state that has more than one-half of its electric load served within the region, but instead both the law and the proposed regulations require the Commission to establish a Regional Advisory Body when two-thirds of the states representing more than one-half of the region's

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

electric load submit a petition for status as a Regional Advisory Body. It states that Missouri is currently divided among three different regional reliability councils with 48 percent of MWh sales in MAIN, 33 percent in SPP and 19 percent in SERC – none representing more than one-half of the electric load – a requirement under the proposed regulations. It is extremely important to the Missouri Commission for Missouri to be represented on all Regional Advisory Bodies associated with Regional Entities that include load or generation located within the state of Missouri. It requests the Commission not to limit participation in a Regional Advisory Body to states having more than one-half of the electric load in the region.

850. Pointing out an apparent inconsistency between the proposed section 38.10(a) and section 215 (j) of the FPA, several commenters[268] ask that the Commission amend its proposed rule to accurately reflect its mandatory obligation to establish a Regional Advisory Body upon petition by the states. They claim that section 215(j) requires the Commission to establish a Regional Advisory Body once it receives a petition whereas the proposed rule provides that "The Commission shall consider a petition to establish a Regional Advisory Body that is submitted by at least two-thirds of the states within a region that have more than one-half of their electric load served within the region."

[268] See, e.g., CREPC, the Missouri Commission and Western Governors.

Commission Conclusion

851. We agree that it would generally be desirable to have a Regional Entity and a Regional Advisory Body cover the same region. However, we disagree that the formation of a Regional Advisory Body must follow the creation and final approval of a Regional Entity, as some commenters suggest. Section 215 of the FPA does not create such a limitation. As Progress Energy and Santee Cooper point out, section 215 permits a Regional Advisory Body to form even if there is no Regional Entity. Further, one function of a Regional Advisory Body under section 215 of the FPA is to advise the Commission and the ERO regarding the governance of a proposed Regional Entity, suggesting that a Regional Advisory Body may be created ahead of a Regional Entity.

852. NARUC prefers a common boundary, but claims that a rigid requirement of a common boundary may interfere with the prospect of consolidating various Regional Entities, especially in the Midwest. We agree. A common boundary may be preferable in many instances, but we will not require a Regional Advisory Body and a Regional Entity to have a common boundary because such a requirement may hinder the prospect of consolidation of various Regional Entities in the future.

853. We agree with NARUC and the Ohio Commission that many questions will arise with respect to adequate representation and voting power of the various states in a Regional Advisory Body as well as the scope of the matters on which a Regional Advisory Body can give advice. We also agree with NARUC that the Commission does not need to address those issues here. Those proposing a Regional Advisory Body are

free to develop a voting structure for submission with the Regional Advisory Body petition.

854. We agree with NARUC that a greater precision in the degree of deference we give to the advice we receive from a Regional Advisory Body organized on an Interconnection-wide basis is not needed and would largely depend upon the particular circumstances of the case. We also agree with NARUC that entities other than a Regional Advisory Body may offer advice on reliability and that a Regional Advisory Body may offer advice outside the scope of the statute; we will address such matters when they arise.

855. The concerns expressed by the Missouri Commission and the Ohio Commission regarding individual state participation in one or more Regional Advisory Body are unfounded. We clarify that the "two-thirds" and "one-half" are legislative requirements for the Commission establishing a Regional Advisory Body, not a requirement for participation. A state within a Regional Entity with less than one-half of its load served in that Regional Entity may still participate in a Regional Advisory Body formed by two-thirds of the other states in the Regional Entity that each have one-half of their load served within that Regional Entity.

856. Finally, several commenters point out an apparent inconsistency between the proposed regulations and section 215 (j) of the FPA and ask that the Commission amend its proposed rule to accurately reflect its mandatory obligation to establish Regional Advisory Bodies upon petition by the states. Accordingly, we are revising section 39.13(a) to state that "The Commission will establish a Regional Advisory Body on the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

petition of at least two-thirds of the States within a region that have more than one-half of their electric load served within the region."

V. INFORMATION COLLECTION STATEMENT

857. The following collection of information contained in this Final Rule is being submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the Paperwork Reduction Act of 1995.[269] The information collection requirements in this Final Rule are identified under the data collection, FERC-725 "Certification of Electric Reliability Organization." The "public protection" provisions of the Paperwork Reduction Act[270] require each agency to display a currently valid control number and inform respondents that a response is not required unless the information collection displays a valid OMB control number on each information collection or provides a justification as to why the information collection number cannot be displayed. In the case of information collections published in regulations, the control number is to be published in the Federal Register. At the time of submission of the NOPR, OMB did not assign a control number and the Commission will request the control number with this submission. Therefore, in compliance with the provisions of the PRA, the Commission may not conduct or sponsor a collection of information unless the OMB control number is displayed.

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[269] 44 U.S.C. 3507(d) (2000).

[270] 44 U.S.C. 3512; 5 CFR 1320.5(b), 1320.6(a) (2000).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

858. **Public Reporting Burden:** In the NOPR, the Commission estimated the potential number of applicants to be recognized by the Commission as the single ERO or as a Regional Entity would vary as up to three (3) for the ERO and up to eight (8) for the Regional Entities, respectively. As these entities are select, special purpose entities of the new federal law and do not yet exist, it was not feasible to project the anticipated burden of complying with the proposed rule. However, staff conducted an outreach on the anticipated burden per response and now provides the following estimate for the certification application.

Data Collection	*No. of Respondents*	*No. of Responses*	*Hours Per Response*	*Total Annual Hours Per Response*
FERC-725	3	1	25,800*	77,400

*These hours take into account the full array of personnel required to plan, develop, prepare and complete an information collection. This includes the time devoted by the respondent, all employees, partners and associates of the respondent, and the time of outside consultants, contractors, legal and financial advisors needed for the purpose of responding to the information. This includes obtaining specialized advice on how to respond and implement the information collection and also searching all available public and private sources of data, including sources which do not yet exist but which might need to be created pursuant to the information collection, and evaluating such sources to determine whether they satisfy the information collection.

Information Collection Costs: Based on input provided to the Commission, the following is a projection of the average cost for submission of the application for certification:

Annualized Capital/Startup Costs: $2,800,000 (this includes direct labor overhead costs to prepare the application and also consultation to obtain specialized advice in responding to and implementing the certification application).

Annualized Costs (Operations & maintenance): As noted above, the entities do not exist at this time and therefore it would be impractical to determine the annual operations and maintenance costs for the applicant selected to become the ERO.

Title: FERC-725, Certification of Electric Reliability Organization.

Action: Proposed Information Collection

OMB Control No: To be determined

Respondents: Non-profit institutions.

Necessity of the Information: The information collected from the ERO or Regional Entities under the requirements of FERC-725 is used by the Commission to implement the statutory provisions of section 215 of the FPA and implemented by the Commission in the Code of Federal Regulations under 18 Part 39. Prior to the enactment of section 215 of the FPA under EPAct, the Commission had acted primarily as an economic regulator of wholesale power markets and the interstate transmission grid promoting a more reliable Bulk-Power System by facilitating regional coordination and planning of the interstate grid through ISOs and RTOs, adopting transmission pricing policies that provide price signals for the most reliable and efficient operation and expansion of the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

grid, and providing pricing incentives at the wholesale level for investment in grid improvements. EPAct buttresses the Commission's efforts to strengthen the interstate transmission grid through the grant of new authority pursuant to section 215 of the FPA which provides for a system of mandatory Reliability Standards developed by the ERO, established by the Commission, and enforced by the ERO and Regional Entities, subject to Commission review.

For information on the requirements, submitting comments on the collection of information and the associated burden estimates including suggestions for reducing this burden, please send your comments to the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C., 20426 (Attention: Michael Miller, Office of the Executive Director, 202-502-8415, e-mail: michael.miller@ferc.gov) or contact the Office of Management and Budget (Attention: Desk Officer for the Federal Energy Regulatory Commission, fax: 202-395-7285, e-mail: oria_submission@omb.eop.gov.)

VI. ENVIRONMENTAL ANALYSIS

859. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.[271] The Commission concludes that neither an Environmental Assessment or an Environmental Impact Statement is required for this Final Rule

[271] Regulations Implementing the National Environmental Policy Act, Order No. 486, 52 FR 47,897 (Dec. 17, 1987), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶ 30,783 (1987).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

pursuant to section 380.4(a)(2)(ii) of the Commission regulations, which provides a "categorical exclusion" for rules that do not substantively change the effect of legislation.[272]

VII. REGULATORY FLEXIBILITY ACT CERTIFICATION

860. The Regulatory Flexibility Act (RFA)[273] directs all agencies to consider the potential impact of regulations on small business and other small entities. The RFA mandates consideration of regulatory alternatives that accomplish the stated objectives of a proposed rule and that minimize any significant economic impact on such entities. The RFA does not, however, mandate any particular outcome in a rulemaking. Under the RFA, an agency must prepare an initial regulatory flexibility analysis of the proposed rule's economic impact on small entities.[274] The analysis requirement may be avoided if the head of the agency certifies in the NOPR that the proposed rule will not "have a significant economic impact on a substantial number of small entities" and sends the certification to the Chief Counsel for Advocacy of the Small Business Administration (SBA).[275] The SBA's Office of Size Standards develops the numerical definition of a small business. (See 13 CFR 121.201). For electric utilities, a firm is small if, including

[272] 18 CFR 380.4(a)(2)(ii) (2005).

[273] 5 U.S.C. 601-612 (2000).

[274] 5 U.S.C. 603(a).

[275] 5 U.S.C. 605(b).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

its affiliates, it is primarily engaged in the generation, transmission and/or distribution of electric energy for sale and its total electric output for the preceding 12 months did not exceed four million megawatt hours.

861. In the NOPR, the Commission certified that the proposed reliability rule would not likely impact certain small entities because the ERO and Regional Entities will be unlike most other businesses, either profit or not-for-profit. In creating the concept of the ERO and Regional Entities, Congress selected special purpose entities to both oversee the transition from voluntary industry reliability requirements for operating and planning the Bulk-Power System to mandatory, Commission-approved, enforceable electric Reliability Standards.

Comments

862. In response to the Commission's certification, several commenters including APPA, NERC and NRECA believe the Commission has misapplied the provisions of the RFA. NRECA contends that the Small Business Regulatory Enforcement Fairness Act (SBREFA) provides an additional statutory reason to the RFA to have the Commission exempt small electric utilities, particularly distribution cooperatives from coverage under the Reliability Standards. Many of NRECA's members, including all of its distribution cooperatives and some of its generation and transmission facilities, qualify as small entities under the statute, as do a number of public power entities and the potential exists that even some investor or privately-owned utilities that operate exclusively or primarily at retail. In NRECA's estimation, many of the small entities generally do not interact directly with the Bulk-Power System. Making such entities directly subject to the

Reliability Standards for the Bulk-Power System would impose additional costs without producing any corresponding improvement in reliability. In NRECA's judgment, the Commission's regulations should explicitly require the ERO to be sensitive to the impact of the Reliability Standards upon small entities, and the ERO should exempt small entities from the Reliability Standards to the extent possible consistent with maintaining the reliability of the Bulk-Power System.

863. APPA believes the Commission's RFA analysis is incorrect. APPA cites section 215(b)(1) of the FPA as granting the Commission reliability jurisdiction over all users, owners and operators of the Bulk-Power System within the United States. This jurisdiction includes and is not limited to the entities described in section described in section 201(f) of the FPA. APPA contends the regulatory scheme spelled out by the Commission in the NOPR is not restricted to just the ERO, Regional Entities and Regional Advisory Bodies. Rather, APPA believes the jurisdiction will encompass all users, owners and operators of the Bulk-Power System. For this reason, APPA asserts that the Commission should revise its RFA analysis to reflect this broader scope of section 215 of the FPA.

864. While APPA acknowledges its support for enactment of section 215 of the FPA, it recognizes that a substantial number of its members (as entities described in section 201(f) of the FPA) would be subject to the statute. But the majority of the nearly 2,000 publicly owned utility systems in the United States are distribution-only utilities that have little or no interaction with the Bulk-Power System. APPA estimates that approximately 1,970 public power utilities meet the SBA standard for a "small utility" used by the

Commission for RFA purposes. APPA assumes that the new ERO, the Regional Entities and the Commission will focus their reliability efforts on those entities whose activities substantially impact the Bulk-Power System, and that distribution-only entities will not be targeted. If this assumption is valid, then the Commission's ultimate conclusion under the RFA that the NOPR does not impact a substantial number of small entities is likely to be correct, although not for the reasons the Commission provides. If however, the Commission were to interpret its reliability jurisdiction more broadly, APPA believes this interpretation would be clearly erroneous and have very substantial RFA compliance issues. In conclusion, APPA hopes the new ERO and the Commission will focus their reliability efforts on only those entities whose activities substantially impact the Bulk-Power System, and not target distribution-only entities.

865. NERC takes an approach that is similar to APPA's in terms of coverage under the RFA and yet different from APPA in terms of applicability. NERC contends that the Commission's regulations should make clear that all users, owners and operators of the Bulk-Power System must comply with: (1) implementation of EPAct, (2) approved Reliability Standards, (3) Rules adopted by the ERO, and (4) requests for data submitted by the ERO and Regional Entities issued in furtherance of section 215 of the FPA. In essence, NERC believes that the Commission must place all users of the Bulk-Power System on notice of their obligations under the FPA and the Commission's regulations. Such notice ensures complete coverage as provided for in EPAct and the regulations proposed by the Commission, the ERO and the Regional Entities who are charged with monitoring and enforcing approved Reliability Standards.

Commission Conclusion

866. As we noted previously in Part IV of the Preamble, this Final Rule is generally limited to developing and implementing the procedures for the formulation and functions of the ERO and Regional Entities as directed by Section 215(b) of the FPA. The Final Rule does not place any significant or substantial impact on entities other than the ERO and the Regional Entities. Section 215 of the FPA provides the Commission with jurisdiction over all users, owners and operators of the Bulk-Power System for purposes of ensuring compliance with the Reliability Standards. Until the Commission has approved a specific Reliability Standard that impacts a particular type/class of users, it is premature to consider NRECA's and APPA's concerns and RFA implications, if any, of the Commission's implementation of section 215 of the FPA.

867. As we noted in the NOPR, Congress created the concept of ERO and Regional Entities to be special purpose entities responsible for the Bulk-Power System and subject to Commission jurisdiction and oversight. Section 215(b) of the FPA merely establishes the criteria for the selection of these organizations so they may in turn propose and enforce Reliability Standards subject to the Commission approval for the Bulk-Power System. It is for these reasons that the Commission affirmed its certification statement contained in the NOPR and reaffirms here that the Final Rule will not have a significant impact on small entities.

VIII. DOCUMENT AVAILABILITY

868. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (http://www.ferc.gov) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington, D.C., 20426.

869. From the Commission's Home Page on the Internet, this information is available in the Commission's document management system, eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

870. User assistance is available for eLibrary and the FERC's website during normal business hours. For assistance, please contact FERC Online Support at 1-866-208-3676 (toll free) or 202-502-6652 (e-mail at FERCOnlineSupport@FERC.gov), or the Public Reference Room at 202-502-8371, TTY 202-502-8659 (e-mail at public.referenceroom@ferc.gov).

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

List of Subjects in 18 C.F.R. Part 40

Administrative practice and procedure; electric power; penalties; reporting and recordkeeping requirements.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

In consideration of the foregoing, the Commission amends Chapter I, Title 18, Code of Federal Regulations, by adding Part 39 to read as follows:

PART 39 -- RULES CONCERNING

CERTIFICATION OF THE ELECTRIC RELIABILITY ORGANIZATION;

AND PROCEDURES FOR THE ESTABLISHMENT, APPROVAL, AND

ENFORCEMENT OF ELECTRIC RELIABILITY STANDARDS

Sec.

39.1 Definitions.

39.2 Jurisdiction and applicability.

39.3 Electric Reliability Organization certification.

39.4 Funding of the Electric Reliability Organization.

39.5 Reliability Standards.

39.6 Conflict of a Reliability Standard with a Commission order.

39.7 Enforcement of Reliability Standards.

39.8 Delegation to a Regional Entity.

39.9 Enforcement of Commission rules and orders.

39.10 Changes to an Electric Reliability Organization Rule or Regional Entity Rule.

39.11 Reliability reports.

39.12 Review of state action.

39.13 Regional Advisory Bodies.

Authority: 16 U.S.C. 824o.

§ 39.1 Definitions.

As used in this part:

Bulk-Power System means facilities and control systems necessary for operating an interconnected electric energy transmission network (or any portion thereof), and electric energy from generating facilities needed to maintain transmission system reliability. The term does not include facilities used in the local distribution of electric energy.

Cross-Border Regional Entity means a Regional Entity that encompasses a part of the United States and a part of Canada or Mexico.

Cybersecurity Incident means a malicious act or suspicious event that disrupts, or was an attempt to disrupt, the operation of those programmable electronic devices and communications networks including hardware, software and data that are essential to the Reliable Operation of the Bulk-Power System.

Electric Reliability Organization or "ERO" means the organization certified by the Commission under § 39.3 the purpose of which is to establish and enforce Reliability Standards for the Bulk-Power System, subject to Commission review.

Electric Reliability Organization Rule means, for purposes of this part, the bylaws, a rule of procedure or other organizational rule or protocol of the Electric Reliability Organization.

Interconnection means a geographic area in which the operation of Bulk-Power System components is synchronized such that the failure of one or more of such

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

components may adversely affect the ability of the operators of other components within the system to maintain Reliable Operation of the facilities within their control.

Regional Advisory Body means an entity established upon petition to the Commission pursuant to section 215(j) of the Federal Power Act that is organized to advise the Electric Reliability Organization, a Regional Entity, or the Commission regarding certain matters in accordance with § 39.13.

Regional Entity means an entity having enforcement authority pursuant to § 39.8.

Regional Entity Rule means, for purposes of this part, the bylaws, a rule of procedure or other organizational rule or protocol of a Regional Entity.

Reliability Standard means a requirement approved by the Commission under section 215 of the Federal Power Act, to provide for Reliable Operation of the Bulk-Power System. The term includes requirements for the operation of existing Bulk-Power System facilities, including cybersecurity protection, and the design of planned additions or modifications to such facilities to the extent necessary to provide for Reliable Operation of the Bulk-Power System, but the term does not include any requirement to enlarge such facilities or to construct new transmission capacity or generation capacity.

Reliable Operation means operating the elements of the Bulk-Power System within equipment and electric system thermal, voltage, and stability limits so that instability, uncontrolled separation, or cascading failures of such system will not occur as a result of a sudden disturbance, including a Cybersecurity Incident, or unanticipated failure of system elements.

Transmission Organization means a regional transmission organization, independent system operator, independent transmission provider, or other transmission organization finally approved by the Commission for the operation of transmission facilities.

§ 39.2 Jurisdiction and applicability.

(a) Within the United States (other than Alaska and Hawaii), the Electric Reliability Organization, any Regional Entities, and all users, owners and operators of the Bulk-Power System, including but not limited to entities described in section 201(f) of the Federal Power Act, shall be subject to the jurisdiction of the Commission for the purposes of approving Reliability Standards established under section 215 of the Federal Power Act and enforcing compliance with section 215 of the Federal Power Act.

(b) All entities subject to the Commission's reliability jurisdiction under paragraph (a) of this section shall comply with applicable Reliability Standards, the Commission's regulations, and applicable Electric Reliability Organization and Regional Entity Rules made effective under this part.

(c) Each user, owner and operator of the Bulk-Power System within the United States (other than Alaska and Hawaii) shall register with the Electric Reliability Organization and the Regional Entity for each region within which it uses, owns or operates Bulk-Power System facilities, in such manner as prescribed in the Rules of the Electric Reliability Organization and each applicable Regional Entity.

(d) Each user, owner or operator of the Bulk-Power System within the United States (other than Alaska and Hawaii) shall provide the Commission, the Electric

Reliability Organization and the applicable Regional Entity such information as is necessary to implement section 215 of the Federal Power Act as determined by the Commission and set out in the Rules of the Electric Reliability Organization and each applicable Regional Entity. The Electric Reliability Organization and each Regional Entity shall provide the Commission such information as is necessary to implement section 215 of the Federal Power Act.

§ 39.3 Electric Reliability Organization certification.

(a) Any person may submit an application to the Commission for certification as the Electric Reliability Organization no later than **[insert date sixty (60) days following Commission issuance of the Final Rule]**. Such application shall comply with the requirements for filings in proceedings before the Commission in part 385 of this chapter.

(b) After notice and an opportunity for public comment, the Commission may certify one such applicant as an Electric Reliability Organization, if the Commission determines such applicant:

(1) Has the ability to develop and enforce, subject to § 39.7, Reliability Standards that provide for an adequate level of reliability of the Bulk-Power System, and

(2) Has established rules that:

(i) Assure its independence of users, owners and operators of the Bulk-Power System while assuring fair stakeholder representation in the selection of its directors and balanced decisionmaking in any Electric Reliability Organization committee or subordinate organizational structure;

(ii) Allocate equitably reasonable dues, fees and charges among end users for all activities under this part;

(iii) Provide fair and impartial procedures for enforcement of Reliability Standards through the imposition of penalties in accordance with § 39.7, including limitations on activities, functions, operations, or other appropriate sanctions or penalties;

(iv) Provide reasonable notice and opportunity for public comment, due process, openness, and balance of interests in developing Reliability Standards, and otherwise exercising its duties; and

(v) Provide appropriate steps, after certification by the Commission as the Electric Reliability Organization, to gain recognition in Canada and Mexico.

(c) The Electric Reliability Organization shall submit an assessment of its performance three years from the date of certification by the Commission, and every five years thereafter. After receipt of the assessment, the Commission will establish a proceeding with opportunity for public comment in which it will review the performance of the Electric Reliability Organization.

(1) The Electric Reliability Organization's assessment of its performance shall include:

(i) An explanation of how the Electric Reliability Organization satisfies the requirements of § 39.3(b);

(ii) Recommendations by Regional Entities, users, owners, and operators of the Bulk-Power System, and other interested parties for improvement of the Electric

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Organization's operations, activities, oversight and procedures, and the Electric Reliability Organization's response to such recommendations; and

(iii) The Electric Reliability Organization's evaluation of the effectiveness of each Regional Entity, recommendations by the Electric Reliability Organization, users, owners, and operators of the Bulk-Power System, and other interested parties for improvement of the Regional Entity's performance of delegated functions, and the Regional Entity's response to such evaluation and recommendations.

(2) The Commission will issue an order finding that the Electric Reliability Organization meets the statutory and regulatory criteria or directing the Electric Reliability Organization or a Regional Entity to come into compliance with or improve its compliance with the requirements of this part. If the ERO fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order, including, if necessary and appropriate, a proceeding to consider decertification of the ERO consistent with § 39.9. The Commission will issue an order finding that each Regional Entity meets the statutory and regulatory criteria or directing the Regional Entity to come into compliance with or improve its compliance with the requirements of this part. If a Regional Entity fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order, including, if necessary and appropriate, a proceeding to consider rescission of its approval of the Regional Entity's delegation agreement.

§ 39.4 Funding of the Electric Reliability Organization.

(a) Any person who submits an application for certification as the Electric Reliability Organization shall include in its application a formula or method for the allocation and assessment of Electric Reliability Organization dues, fees and charges. The certified Electric Reliability Organization may subsequently file with the Commission a request to modify the formula or method.

(b) The Electric Reliability Organization shall file with the Commission its proposed entire annual budget for statutory and any non-statutory activities, including the entire annual budget for statutory and any non-statutory activities of each Regional Entity, with supporting materials, including the ERO's and each Regional Entity's complete business plan and organization chart, explaining the proposed collection of all dues, fees and charges and the proposed expenditure of funds collected in sufficient detail to justify the requested funding collection and budget expenditures 130 days in advance of the beginning of each Electric Reliability Organization fiscal year. The annual Electric Reliability Organization budget shall include line item budgets for the activities of each Regional Entity that are delegated or assigned to each Regional Entity pursuant to § 39.8.

(c) The Commission, after public notice and opportunity for hearing, shall issue an order either accepting, rejecting, remanding or modifying the proposed Electric Reliability Organization budget and business plan no later than sixty (60) days in advance of the beginning of the Electric Reliability Organization's fiscal year.

(d) On a demonstration of unforeseen and extraordinary circumstances requiring additional funds prior to the next Electric Reliability Organization fiscal year, the Electric

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Reliability Organization may file with the Commission for authorization to collect a special assessment. Such filing shall include supporting materials explaining the proposed collection in sufficient detail to justify the requested funding, including any departure from the approved funding formula or method. After notice and an opportunity for hearing, the Commission will approve, disapprove, remand or modify such request.

(e) All entities within the Commission's jurisdiction as set forth in section 215(b) of the Federal Power Act shall pay any Electric Reliability Organization assessment of dues, fees and charges as approved by the Commission, in a timely manner reasonably as designated by the Electric Reliability Organization.

(f) Any person who submits an application for certification as the Electric Reliability Organization may include in the application a plan for a transitional funding mechanism that would allow such person, if certified as the Electric Reliability Organization, to continue existing operations without interruption as it transitions from one method of funding to another. Any proposed transitional funding plan should terminate no later than eighteen (18) months from the date of Electric Reliability Organization certification.

(g) The Electric Reliability Organization or a Regional Entity may not engage in any activity or receive revenues from any person that, in the judgment of the Commission represents a significant distraction from, or a conflict of interest with, its responsibilities under this part.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

§ 39.5 Reliability Standards.

(a) The Electric Reliability Organization shall file each Reliability Standard or modification to a Reliability Standard that it proposes to be made effective under this part with the Commission. The filing shall include a concise statement of the basis and purpose of the proposed Reliability Standard, either a summary of the Reliability Standard development proceedings conducted by the Electric Reliability Organization or a summary of the Reliability Standard development proceedings conducted by a Regional Entity together with a summary of the Reliability Standard review proceedings of the Electric Reliability Organization, and a demonstration that the proposed Reliability Standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest.

(b) The Electric Reliability Organization shall rebuttably presume that a proposal for a Reliability Standard or a modification to a Reliability Standard to be applicable on an Interconnection-wide basis is just, reasonable, not unduly discriminatory or preferential, and in the public interest, if such proposal is from a Regional Entity organized on an Interconnection-wide basis.

(c) The Commission may approve by rule or order a proposed Reliability Standard or a proposed modification to a Reliability Standard if, after notice and opportunity for public hearing, it determines that the proposed Reliability Standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest.

(1) The Commission will give due weight to the technical expertise of the Electric Reliability Organization with respect to the content of a proposed Reliability Standard or a proposed modification to a Reliability Standard,

(2) The Commission will give due weight to the technical expertise of a Regional Entity organized on an Interconnection-wide basis with respect to a proposed Reliability Standard or a proposed modification to a Reliability Standard to be applicable within that Interconnection, and

(3) The Commission will not defer to the Electric Reliability Organization or a Regional Entity with respect to the effect of a proposed Reliability Standard or a proposed modification to a Reliability Standard on competition.

(d) An approved Reliability Standard or modification to a Reliability Standard shall take effect as approved by the Commission.

(e) The Commission will remand to the Electric Reliability Organization for further consideration a proposed Reliability Standard or modification to a Reliability Standard that the Commission disapproves in whole or in part.

(f) The Commission may, upon its own motion or a complaint, order the Electric Reliability Organization to submit a proposed Reliability Standard or modification to a Reliability Standard that addresses a specific matter if the Commission considers such a new or modified Reliability Standard appropriate to carry out section 215 of the Federal Power Act.

(g) The Commission, when remanding a Reliability Standard to the Electric Reliability Organization or ordering the Electric Reliability Organization to submit to the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Commission a proposed Reliability Standard or proposed modification to a Reliability Standard that addresses as specific matter may order a deadline by which the Electric Reliability Organization must submit a proposed or modified Reliability Standard.

§ 39.6 Conflict of a Reliability Standard with a Commission Order.

(a) If a user, owner or operator of the transmission facilities of a Transmission Organization determines that a Reliability Standard may conflict with a function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission with respect to such Transmission Organization, the Transmission Organization shall expeditiously notify the Commission, the Electric Reliability Organization and the relevant Regional Entity of the possible conflict.

(b) After notice and opportunity for hearing, within sixty (60) days of the date that a notice was filed under paragraph (a) of this section, unless the Commission orders otherwise, the Commission will issue an order determining whether a conflict exists and, if so, resolve the conflict by directing:

(1) The Transmission Organization to file a modification of the conflicting function, rule, order, tariff, rate schedule, or agreement pursuant to section 205 or 206 of the Federal Power Act, as appropriate, or

(2) The Electric Reliability Organization to propose a modification to the conflicting Reliability Standard pursuant to § 39.5 of the Commission's regulations.

(c) The Transmission Organization shall continue to comply with the function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission until the Commission finds that a conflict exists, the Commission orders a

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

change to such provision pursuant to section 205 or 206 of the Federal Power Act, and the ordered change becomes effective.

§ 39.7 Enforcement of Reliability Standards.

(a) The Electric Reliability Organization and each Regional Entity shall have an audit program that provides for rigorous audits of compliance with Reliability Standards by users, owners and operators of the Bulk-Power System.

(b) The Electric Reliability Organization and each Regional Entity shall have procedures to report promptly to the Commission any self-reported violation or investigation of a violation or an alleged violation of a Reliability Standard and its eventual disposition.

(1) Any person that submits an application to the Commission for certification as an Electric Reliability Organization shall include in such application a proposal for the prompt reporting to the Commission of any self-reported violation or investigation of a violation or an alleged violation of a Reliability Standard and its eventual disposition.

(2) Any agreement for the delegation of enforcement authority to a Regional Entity shall include a provision for the prompt reporting through the Electric Reliability Organization to the Commission of any self-reported violation or investigation of a violation or an alleged violation of a Reliability Standard and its eventual disposition.

(3) Each report of a violation or alleged violation by a user, owner or operator of the Bulk-Power System shall include the user's, owner's or operator's name, which Reliability Standard or Reliability Standards were violated or allegedly violated, when the violation or alleged violation occurred, and the name of a person knowledgeable

about the violation or alleged violation to serve as a point of contact with the Commission.

(4) Each violation or alleged violation shall be treated as nonpublic until the matter is filed with the Commission as a notice of penalty or resolved by an admission that the user, owner or operator of the Bulk-Power System violated a Reliability Standard or by a settlement or other negotiated disposition. The disposition of each violation or alleged violation that relates to a Cybersecurity Incident or that would jeopardize the security of the Bulk-Power System if publicly disclosed shall be nonpublic unless the Commission directs otherwise.

(5) The Electric Reliability Organization, and each Regional Entity through the ERO, shall file such periodic summary reports as the Commission shall from time to time direct on violations of Reliability Standards and summary analyses of such violations.

(c) The Electric Reliability Organization, or a Regional Entity, may impose, subject to section 215(e) of the Federal Power Act, a penalty on a user, owner or operator of the Bulk-Power System for a violation of a Reliability Standard approved by the Commission if, after notice and opportunity for hearing:

(1) The Electric Reliability Organization or the Regional Entity finds that the user, owner or operator has violated a Reliability Standard approved by the Commission; and

(2) The Electric Reliability Organization files a notice of penalty and the record of its or a Regional Entity's proceeding with the Commission. Simultaneously with the filing of a notice of penalty with the Commission, the Electric Reliability Organization shall serve a copy of the notice of penalty on the entity that is the subject of the penalty.

(d) A notice of penalty by the Electric Reliability Organization shall consist of:

(1) The name of the entity on whom the penalty is imposed;

(2) Identification of each Reliability Standard violated;

(3) A statement setting forth findings of fact with respect to the act or practice resulting in the violation of each Reliability Standard;

(4) A statement describing any penalty imposed;

(5) The record of the proceeding;

(6) A form of notice suitable for publication; and

(7) Other matters the Electric Reliability Organization or the Regional Entity, as appropriate, may find relevant.

(e) A penalty imposed under this section may take effect not earlier than the thirty-first (31st) day after the Electric Reliability Organization files with the Commission the notice of penalty and the record of the proceedings.

(1) Such penalty shall be subject to review by the Commission, on its own motion or upon application by the user, owner or operator of the Bulk-Power System that is the subject of the penalty filed within thirty (30) days after the date such notice is filed with Commission. In the absence of the filing of an application for review or motion or other action by the Commission, the penalty shall be affirmed by operation of law upon the expiration of the thirty (30)-day period for filing of an application for review.

(2) An applicant filing an application for review shall comply with the requirements for filings in proceedings before the Commission. An application shall contain a complete and detailed explanation of why the applicant believes that the

Electric Reliability Organization or Regional Entity erred in determining that the applicant violated a Reliability Standard, or in determining the appropriate form or amount of the penalty. The applicant may support its explanation by providing information that is not included in the record submitted by the Electric Reliability Organization.

(3) Application to the Commission for review, or the initiation of review by the Commission on its own motion, shall not operate as a stay of such penalty unless the Commission otherwise orders upon its own motion or upon application by the user, owner or operator that is the subject of such penalty.

(4) Any answer, intervention or comment to an application for review of a penalty imposed under this part must be filed within twenty (20) days after the application is filed, unless otherwise ordered by the Commission.

(5) In any proceeding to review a penalty imposed under this part, the Commission, after public notice and opportunity for hearing (which hearing may consist solely of the record before the Electric Reliability Organization or Regional Entity and the opportunity for the presentation of supporting reasons to affirm, modify, or set aside the penalty), will by order affirm, set aside, or modify the penalty or may remand the determination of a violation or the form or amount of the penalty to the Electric Reliability Organization for further consideration. The Commission may establish a hearing before an administrative law judge or initiate such further procedures as it determines to be appropriate, before issuing such an order. In the case of a remand to the Electric Reliability Organization, the Electric Reliability Organization may remand the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

matter to a Regional Entity for further consideration and resubmittal through the Electric Reliability Organization to the Commission.

(6) The Commission will take action on an application for review of a penalty within sixty (60) days of the date the application is filed unless the Commission determines on a case-by-case basis that an alternative expedited procedure is appropriate.

(7) A proceeding for Commission review of a penalty for violation of a Reliability Standard will be public unless the Commission determines that a nonpublic proceeding is necessary and lawful, including a proceeding involving a Cybersecurity Incident. For a nonpublic proceeding, the user, owner or operator of the Bulk-Power System that is the subject of the penalty will be given timely notice and an opportunity for hearing and the public will not be notified and the public will not be allowed to participate.

(f) On its own motion or upon complaint, the Commission may order compliance with a Reliability Standard and may impose a penalty against a user, owner or operator of the Bulk-Power System, if the Commission finds, after public notice and opportunity for hearing, that the user, owner or operator of the Bulk-Power System has engaged or is about to engage in any acts or practices that constitute or will constitute a violation of a Reliability Standard.

(g) Any penalty imposed for the violation of a Reliability Standard shall bear a reasonable relation to the seriousness of the violation and shall take into consideration efforts of such user, owner or operator of the Bulk-Power System to remedy the violation in a timely manner.

(1) The penalty imposed may be a monetary or a non-monetary penalty and may include, but is not limited to, a limitation on an activity, function, operation, or other appropriate sanction, including being added to a reliability watch list composed of major violators that is established by the Electric Reliability Organization, a Regional Entity or the Commission.

(2) The Electric Reliability Organization shall submit for Commission approval penalty guidelines that set forth a range of penalties for the violation of Reliability Standards. A penalty imposed by the Electric Reliability Organization or a Regional Entity must be within be within the range set forth in the penalty guidelines.

§ 39.8 Delegation to a Regional Entity.

(a) The Electric Reliability Organization may enter into an agreement to delegate authority to a Regional Entity for the purpose of proposing Reliability Standards to the Electric Reliability Organization and enforcing Reliability Standards under § 39.7.

(b) After notice and opportunity for comment, the Commission may approve a delegation agreement. A delegation agreement shall not be effective until it is approved by the Commission.

(c) The Electric Reliability Organization shall file a delegation agreement. Such filing shall include a statement demonstrating that:

(1) The Regional Entity is governed by an independent board, a balanced stakeholder board, or a combination independent and balanced stakeholder board;

(2) The Regional Entity otherwise satisfies the provisions of section 215(c) of the Federal Power Act; and

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

(3) The agreement promotes effective and efficient administration of Bulk-Power System reliability.

(d) The Commission may modify such delegation.

(e) The Electric Reliability Organization shall and the Commission will rebuttably presume that a proposal for delegation to a Regional Entity organized on an Interconnection-wide basis promotes effective and efficient administration of Bulk-Power System reliability and should be approved.

(f) An entity seeking to enter into a delegation agreement that is unable to reach an agreement with the Electric Reliability Organization within 180 days after proposing a delegation agreement to the Electric Reliability Organization may apply to the Commission to assign to it the Electric Reliability Organization's authority to enforce Reliability Standards within its region. The entity must demonstrate in its application that it meets the requirements of § 39.8(c) and that continued negotiations with the Electric Reliability Organization would not likely result in an appropriate delegation agreement within a reasonable period of time. After notice and opportunity for hearing, the Commission may designate the entity as a Regional Entity and assign enforcement authority to it.

(g) An application pursuant to section 39.8(f) must state:

(i) Whether the Commission's Dispute Resolution Service, or other ADR procedures were used, or why these procedures were not used; and

(ii) Whether the Regional Entity believes that ADR under the Commission's supervision could successfully resolve the disputes regarding the terms of the delegation agreement.

§ 39.9 Enforcement of Commission Rules and Orders.

(a) The Commission may take such action as is necessary and appropriate against the Electric Reliability Organization or a Regional Entity to ensure compliance with a Reliability Standard or any Commission order affecting the Electric Reliability Organization or a Regional Entity, including, but not limited to:

(1) After notice and opportunity for hearing, imposition of civil penalties under the Federal Power Act.

(2) After notice and opportunity for hearing, suspension or decertification of the Commission's certification to be the Electric Reliability Organization.

(3) After notice and opportunity for hearing, suspension or rescission of the Commission's approval of an agreement to delegate certain Electric Reliability Organization authorities to a Regional Entity.

(b) The Commission may periodically audit the Electric Reliability Organization's performance under this part.

§ 39.10 Changes to an Electric Reliability Organization Rule or Regional Entity Rule.

(a) The Electric Reliability Organization shall file with the Commission for approval any proposed Electric Reliability Organization Rule or Rule change. A Regional Entity shall submit a Regional Entity Rule or Rule change to the Electric Reliability Organization and, if approved by the Electric Reliability Organization, the

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Electric Reliability Organization shall file the proposed Regional Entity Rule or Rule change with the Commission for approval. Any filing by the Electric Reliability Organization shall be accompanied by an explanation of the basis and purpose for the Rule or Rule change, together with a description of the proceedings conducted by the Electric Reliability Organization or Regional Entity to develop the proposal.

(b) The Commission, upon its own motion or upon complaint, may propose a change to an Electric Reliability Organization Rule or Regional Entity Rule.

(c) A proposed Electric Reliability Organization Rule or Rule change or Regional Entity Rule or Rule change shall take effect upon a finding by the Commission, after notice and opportunity for public comment, that the change is just, reasonable, not unduly discriminatory or preferential, is in the public interest, and satisfies the requirements of § 39.3.

§ 39.11 Reliability reports.

(a) The Electric Reliability Organization shall conduct assessments as determined by the Commission of the reliability of the Bulk-Power System in North America and provide a report to the Commission and provide subsequent reports of the same to the Commission.

(b) The Electric Reliability Organization shall conduct assessments of the adequacy of the Bulk-Power System in North America and report its findings to the Commission, the Secretary of Energy, each Regional Entity, and each Regional Advisory Body annually or more frequently if so ordered by the Commission.

§ 39.12 Review of state action.

(a) Nothing in this section shall be construed to preempt any authority of any state to take action to ensure the safety, adequacy, and reliability of electric service within that state, as long as such action is not inconsistent with any Reliability Standard, except that the State of New York may establish rules that result in greater reliability within that state, as long as such action does not result in lesser reliability outside the state than that provided by the Reliability Standards.

(b) Where a state takes action to ensure the safety, adequacy, or reliability of electric service, the Electric Reliability Organization, a Regional Entity or other affected person may apply to the Commission for a determination of consistency of the state action with a Reliability Standard.

(1) The application shall:

(i) Identify the state action;

(ii) Identify the Reliability Standard with which the state action is alleged to be inconsistent;

(iii) State the basis for the allegation that the state action is inconsistent with the Reliability Standard; and

(iv) Be served on the relevant state agency and the Electric Reliability Organization, concurrent with its filing with the Commission.

(2) Within ninety (90) days of the application of the Electric Reliability Organization, the Regional Entity, or other affected person, and after notice and opportunity for public comment, the Commission will issue a final order determining

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

whether the state action is inconsistent with a Reliability Standard, taking into consideration any recommendation of the Electric Reliability Organization and the state.

(c) The Commission, after consultation with the Electric Reliability Organization and the state taking action, may stay the effectiveness of the state action, pending the Commission's issuance of a final order.

§ 39.13 Regional Advisory Bodies.

(a) The Commission will establish a Regional Advisory Body on the petition of at least two-thirds of the states within a region that have more than one-half of their electric load served within the region.

(b) A petition to establish a Regional Advisory Body shall include a statement that the Regional Advisory Body is composed of one member from each participating state in the region, appointed by the governor of each state, and may include representatives of agencies, states and provinces outside the United States.

(c) A Regional Advisory Body established by the Commission may provide advice to the Electric Reliability Organization or a Regional Entity or the Commission regarding:

(1) The governance of an existing or proposed Regional Entity within the same region;

(2) Whether a Reliability Standard proposed to apply within the region is just, reasonable, not unduly discriminatory or preferential, and in the public interest;

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

(3) Whether fees for all activities under this part proposed to be assessed within the region are just, reasonable, not unduly discriminatory or preferential, and in the public interest; and

(4) Any other responsibilities requested by the Commission.

(d) The Commission may give deference to the advice of a Regional Advisory Body established by the Commission that is organized on an Interconnection-wide basis.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix A – Commenters

Abbreviation	Commenter
AEP	American Electric Power Service Corp.
Alberta	Alberta Department of Energy; Alberta Utilities and Energy Board; Alberta Electric System Operator
Alcoa	Alcoa, Inc. and Alcoa Power Generating Company
Allegheny	Allegheny Power and Allegheny Energy Supply Company, LLC
Ameren	Ameren Services Company
American Transmission	American Transmission Company, LLC
APPA	American Public Power Association
AWEA	American Wind Energy Association
BCTC	British Columbia Transmission Corporation
California Board	California Electricity Oversight Board
California Commission	Public Utilities Commission of the State of California
California DWR	California Department of Water Resources State Water Project
California ISO	California Independent System Operator Corporation
CEA	Canadian Electricity Association
Centerpoint	Centerpoint Energy Houston Electric, LLC
Chelan County	Chelan County Public Utility District
Cinergy	Cinergy Services, Inc.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

City of San Antonio	City of San Antonio, City Public Service Board
City of Seattle	City of Seattle, Washington
City Utilities Springfield	City Utilities of Springfield, MO
CREPC	Committee On Regional Electric Power Cooperation
Dairyland	Dairyland Power Cooperative
Detroit Edison	The Detroit Edison Company
DOE	United States Department of Energy
Dominion Power	Virginia Electric and Power Company
EEI	Edison Electric Institute
ELCON	Electricity Consumers Resource Council, American Iron and Steel Institute, American Chemistry Council, Council of Industrial Boiler Owners, Portland Cement Association
Empire District Electric	Empire District Electric Company
Entergy	Entergy Services, Inc.
EPSA	Electric Power Supply Association
ERCOT	Electric Reliability Council Of Texas
Exelon	Exelon Corporation
FirstEnergy	FirstEnergy Service Company
Florida Commission	Florida Public Service Commission
FPT Group	Canadian Federal-Provincial-Territorial Assistant Deputy Minister Electricity Working Group

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

FRCC	Florida Reliability Coordinating Council
Hydro One	Hydro One Networks Inc.
Hydro-Québec	Hydro-Québec-TransEnérgie
IEEE	Institute of Electrical and Electronics Engineers - USA
Indianapolis P&L	Indianapolis Power & Light Company
International Transmission	International Transmission Company
International Transmission and Michigan Electric	International Transmission Company and Michigan Electric Transmission Company, LLC, jointly
ISO New England	ISO New England Inc.
ISO/RTO Council	The ISO/RTO Council
Kansas City P&L	Kansas City Power & Light Company
Kentucky PSC	Kentucky Public Service Commission
LADWP	City of Los Angeles Department of Water and Power
LG&E	LG&E Energy LLC
Manitoba	Public Utilities Board of Manitoba
Massachusetts Commission	Massachusetts Department of Telecommunications and Energy
Michigan Electric	Michigan Electric Transmission Company, LLC
MidAmerican	MidAmerican Energy Company
MISO	Midwest Independent Transmission System Operator, Inc.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

MISO Owners	Midwest ISO Transmission Owners
Missouri Commission	Missouri Public Service Commission
MRO	Midwest Reliability Organization
NARUC	National Association of Regulatory Utility Commissioners
NASUCA	The National Association of State Utility Consumer Advocates
National Energy Board	National Energy Board of Canada
National Grid	National Grid USA
NE Pool Participants	New England Power Pool Participants Committee
NEMA	National Electrical Manufacturers Association
NERC	North American Electric Reliability Council
New York Commission	New York State Public Service Commission
New York Companies	Central Hudson Gas & Electric Corporation; Consolidated Edison Company of New York, Inc.; LIPA; New York Power Authority; New York State Electric & Gas Corporation; Orange and Rockland Utilities, Inc.; Rochester Gas and Electric Corporation
New York ISO	New York Independent System Operator, Inc.
NiSource	NiSource Inc.
North Carolina Commission	North Carolina Utilities Commission
Northeast Utilities	Northeast Utilities Service Company
Northern Maine Entities	Northern Maine Independent System Administrator, Inc., Maine Public Service Company, Eastern Maine Electric Cooperative, Inc.
Nova Scotia Board	Nova Scotia Utility and Review Board

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

NPCC	Northeast Power Coordinating Council
NRECA	National Rural Electric Cooperative Association
NYSRC	New York State Reliability Council
Ohio Commission	Public Utilities Commission of Ohio
Oklahoma Commission	Oklahoma Corporation Commission
Old Dominion	Old Dominion Electric Cooperative
Ontario IESO	Ontario Independent Electricity System Operator
PacifiCorp	PacifiCorp
PG&E	Pacific Gas & Electric Company
PJM	PJM Interconnection, L.L.C.
Portland GE	Portland General Electric Company
Progress Energy	Progress Energy, Inc.
PSEG Companies	Public Service Electric & Gas Company, PSEG Energy Resources & Trade LLC, PSEG Power LLC
PSNM-TNPC	Public Service Company of New Mexico, Texas-New Mexico Power Company
Robert Thomas	Robert J. Thomas, Professor of Electrical and Computer Engineering at Cornell University
Santa Clara	City of Santa Clara dba Silicon Valley Power
Santee Cooper	South Carolina Public Service Authority
SERC	Southeastern Electric Reliability Council, Inc.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Siemens	Siemens Power Transmission and Distribution
SMA	Steel Manufacturers Association
SMUD	Sacramento Municipal Utiltiy District
SoCalEd	Southern California Edison Company
South Carolina E&G	South Carolina Electric & Gas Company
Southern	Southern Company Services, Inc.
SPP	Southwest Power Pool
TANC	Transmission Agency of Northern California
TAPS	Transmission Access Policy Study Group
Texas Commission	Public Utilities Commission of Texas
Trexco	Trexco, LLC
TVA	Tennessee Valley Authority
WECC	Western Electricity Coordinating Council
WestConnect	WestConnect Public Utilities
Western Governments	The Council Of State Governments –West
Western Governors	Western Governors' Association
Wisconsin Electric	Wisconsin Electric Power Company
Xcel Energy	Xcel Energy Services, Inc.

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Appendix B

Participants/Filed Statements on November 18, 2005 Technical Conference

American Public Power Association (APPA)
Edison Electric Institute (EEI)
Electric Reliability Council of Texas (ERCOT)
Florida Reliability Coordinating Council (FRCC)
Institute of Electrical and Electronics Engineers, Inc.
Midwest Reliability Organization (MRO)
North American Electric Reliability Council (NERC)
Northeast Power Coordinating Council (NPCC)
United States Nuclear Regulatory Commission (NRC)
National Rural Electric Cooperative Association (NRECA)
New York State Reliability Council (NYSRC)
Ontario Independent Electricity System Operator (Ontario IESO)
Pennsylvania-New Jersey-Maryland Interconnection, L.L.C. (PJM)
ReliabilityFirst Corporation (RFC)
Southeastern Electric Reliability Council, Inc. (SERC)
Southwest Power Pool (SPP)
Tennessee Valley Authority (TVA)
Western Electricity Coordinating Council (WECC)

Participants/Filed Statements on the December 9, 2005 Technical Conference

Alberta Department of Energy (Alberta)
Edison Electric Institute (EEI)
Electricity Consumers Resource Council (ELCON)
Electric Power Supply Association (EPSA)
Florida Public Service Commission (FPSC)
ISO/RTO Council
Maryland Public Service Commission, National Association of Regulatory Utility Commissioners (NARUC)
Midwest Reliability Organization (MRO)
North American Energy Standards Board (NAESB)
National Association of Securities Dealers (NASD)
National Association of State Utility Consumer Advocates (NASUCA)
North American Electric Reliability Council (NERC)
United States Nuclear Regulatory Commission (NRC)
Natural Resources Canada (NRCan)
Organization of MISO States (OMS)
Western Electricity Coordinating Council (WECC)
Western Governor’s Association (WGA)

20060203-3003 Issued by FERC OSEC 02/03/2006 in Docket#: RM05-30-000

Hydro One
Institute of Nuclear Power Operations (INPO)
Securities and Exchange Commission (SEC)