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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

North American Electric Reliability Corporation — Docket No. RR06-1-000

ORDER CERTIFYING NORTH AMERICAN ELECTRIC RELIABILITY CORPORATION AS THE ELECTRIC RELIABILITY ORGANIZATION AND ORDERING COMPLIANCE FILING

(Issued July 20, 2006)

I. Background 6
A. Order No. 672 6
B. Description of NERC 7
C. NERC's ERO Certification Application 8
II. Notice of Filing, Comments and Answers 9
III. Procedural Matters 9
IV. Discussion 9
A. Governance and Balanced Decisionmaking 10
1. Board of Trustees 11
2. General Membership 16
3. Member Representatives Committee and Registered Ballot Body 19
a. Lack of Consistency Among Member Representatives Committee Sectors and Registered Ballot Body Segments 19
b. Member Representatives Committee Composition and Voting 21
c. Registered Ballot Body Composition and Voting 25
4. Other Committees 30
5. Meetings and Voting 34
6. Expertise 38
7. NERC's Reorganization 41
8. Regional Advisory Bodies 41
B. Recognition in Canada and Mexico 43
C. Funding 44
1. Billing and Collections 44
2. Funding of Activities 48
3. Budget Development 53
4. Funding Transition Plan 56

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

5. Other Funding Matters 57
D. Reliability Standard Development Process 59
1. General Issues 59
2. Technical Soundness 62
3. Notice, Opportunity for Comment, Due Process, Openness, and Balance 65
4. Uniformity and Regional Reliability Standard Development 69
5. Remand of a Reliability Standard 77
6. Conflict with a State Action, and Contractual and Reliability Obligations 79
E. Enforcement of Reliability Standards 80
1. General 81
2. Compliance and Readiness 82
a. Compliance Audits 83
b. Reliability Readiness Reviews 87
c. ERO Oversight of Regional Entity Enforcement Programs 91
d. Remedial Actions 95
3. Investigations of Violations and Alleged Violations and Reporting of Violations to the Commission 100
4. Confidentiality of Investigations and Reports 104
5. Penalties, Due Process, and Appeals 110
a. Penalties 110
i. Base Penalty Amount 117
ii. Final Adjustment Factors 120
iii. Other Factors 123
iv. Multiple Violators 123
v. Non-monetary Penalties 124
b. Due Process in Investigations and Initial Hearings 125
c. Appeals to the ERO 130
d. Notice of Penalty and Appeal to the Commission 134
e. ERO Monitoring of Regional Entity Compliance 135
F. Delegation Agreements 137
1. *Pro Forma* Delegation Agreement Requirements 137
a. Uniformity of Delegation Agreements 137
b. Negotiation of Individual Delegation Agreements 141
c. Boundaries of a Regional Entity 143
d. Regional Entity Governance 144
e. Relationship Between the Regional Entity and the ERO 146
f. Specific Terms in NERC's Proposed *Pro Forma* Delegation Agreement 147
i. Covenants 147
ii. Reliability Standards 149
iii. Enforcement 151
iv. Funding 153
vi. Assignment 156
vii. Default and Cure 156

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

viii. Term and Termination 157
viii. Limitation of Liability 158
ix. Amendment to the NERC Rules 159
x. Dispute Resolution 161
xi. Governing Law 162
xii. Savings Clause 163
2. Requirements for Regional Entities in Other Parts of NERC's Application 164
3. Other Contractual Arrangements 165
G. Reliability, Adequacy and Other Information 166
1. General 166
2. NERC's General Treatment of Confidentiality 171
a. General 171
b. Designation of Confidential Information 174
c. Disclosure to Applicable Government Authority 176
d. Breach of Confidentiality 177
H. ERO and Regional Entity Rules 178
I. Compliance Registry 179
1. General 179
2. Concerns about Functional Categories 185
3. Exemptions from Registration 186
4. Implementation of Registration Process 189
J. ERO and Regional Entity Performance Assessment 190
K. Definitions 192

1. In Order No. 672, the Commission established the criteria that an applicant must satisfy to qualify as the single Electric Reliability Organization (ERO) for the United States under section 215 of the Federal Power Act (FPA).[1] The Commission required that ERO applicants submit an application no later than April 4, 2006. The Commission received one application, submitted by the North American Electric Reliability Council (NERC Council), on behalf of its wholly-owned subsidiary, the North American Electric Reliability Corporation (NERC Corp.), (collectively NERC).

2. NERC's proposal includes comprehensive plans for the transition to and maintenance of NERC as the ERO on an ongoing basis. Along with NERC's narrative description of its proposal and qualifications to serve as the ERO, NERC provides a

[1] *Rules Concerning Certification of the Electric Reliability Organization; Procedures for the Establishment, Approval and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204 (2006), *order on reh'g*, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006); *appeal docketed sub nom. New York Independent System Operator v. FERC*, No. 06-1185 (D.C. Cir. May 30, 2006).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Certificate of Incorporation, Bylaws, Rules of Procedure, *pro forma* delegation agreement, and Transition Plan that include detailed rules on such matters as Reliability Standards development, compliance and enforcement, organization registration, reliability audits, reliability assessments, and NERC's annual business plan and budget. Pursuant to its proposal, NERC would be responsible for developing and enforcing the mandatory Reliability Standards to apply to all users, owners and operators of the Bulk-Power System in accordance with new section 215 of the FPA.

3. Based on our review of NERC's ERO certification application and careful consideration of the public comments submitted on NERC's application, the Commission finds that NERC has met the requirements of Order No. 672 and we hereby certify NERC as the ERO for the United States. The Commission commends NERC on its application, which required extensive consultation with stakeholders and was prepared within a short timeframe pursuant to Order No. 672. Most commenters advocate that NERC be certified by the Commission as the ERO but recommend a number of improvements. While the Commission concludes that NERC generally satisfies the criteria to become the ERO responsible for developing and enforcing mandatory Reliability Standards for the United States, as discussed in the body of this order, we direct NERC to provide additional information and make specific revisions to its Rules in a compliance filing to be filed within 90 days of the date of this order.[2] We also require specific modifications to the *pro forma* delegation agreement that should be reflected in the individual delegation agreements submitted by NERC and each individual Regional Entity. We are not requiring NERC to submit a revised *pro forma* delegation agreement before it submits the individual delegation agreements.

4. The Commission continues to believe that a strong ERO is necessary to promote excellence in the development and enforcement of mandatory Reliability Standards, as envisioned in Order No. 672. Once NERC has complied with our directives and negotiated appropriate Regional Entity delegation agreements, it will be well positioned to lead the industry transition from voluntary Reliability Standards to mandatory enforceable Reliability Standards.

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[2] The Commission notes that in certain circumstances, 90 days may be inadequate to address clarifications or revisions required by the Commission. Accordingly, we will consider a reasonable request for an extension of time to file specific elements of the compliance filing. However, we will not leave compliance open-ended. Therefore, if NERC requests an extension of time, it must also provide the Commission with a proposed timetable for achieving compliance with those specific elements for which it seeks an extension.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

5. Below, we summarize the primary elements of NERC's application:

6. **Governance**: NERC proposes to be governed by its existing independent board of directors, which will have responsibility for approving Reliability Standards, electing and appointing officers, appointing committees, handling budgetary and financial matters, and overseeing all ERO programs. NERC's Bylaws require that the board include proportional representation from Canada. Membership in NERC will be voluntary, free, and open to persons and entities with an interest in the reliable operation of the Bulk-Power System. Each member will be assigned to one of twelve membership sectors, which elect the representatives to the member representatives committee. The member representatives committee elects the board; votes on amendments to the Bylaws, and provides advice to the board with respect to the development of budgets, business plans, funding mechanisms, proposed Reliability Standards, and other matters related to NERC's operations.

7. As discussed below, the Commission accepts NERC's proposed governance structure, and requires NERC to provide specific revisions and clarifications in a compliance filing.

8. **Funding**: NERC proposes to allocate its annual reliability program costs among load serving entities on the basis of net energy for load. It further proposes that each Regional Entity bill and collect fees from the load serving entities within its geographic boundaries. NERC intends to submit its annual budget for Commission approval, including funding for delegated activities it has assigned to each Regional Entity.

9. The Commission generally accepts NERC's funding proposal, and requires NERC to establish safeguards regarding the Regional Entity role in collecting fees and charges.

10. **Reliability Standard Development**: NERC proposes to continue the use of its existing open stakeholder process for the development of Reliability Standards that would become mandatory and enforceable upon approval by the Commission. NERC's proposed Reliability Standard development procedure will be implemented by a registered ballot body, administered by a standards process manager, and overseen by a standards committee. Participants in the ballot body will be assigned to one or more stakeholder segments, depending on the nature of their interest in the Bulk-Power System.

11. As discussed in detail below, the Commission accepts NERC's proposed Reliability Standards development process conditioned on NERC providing specific revisions and clarifications in a compliance filing. In particular, we direct NERC to propose a process for the timely development of a Reliability Standard or modification of a Reliability Standard at the direction of the Commission.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

12. **Enforcement**: NERC's proposed enforcement program includes compliance audit and reliability readiness review programs. Further, NERC would establish a compliance monitoring program, procedures for oversight of a Regional Entity enforcement program and an appeals process for review of a Regional Entity finding of a violation or assessment of a penalty. NERC also proposes "ERO Sanction Guidelines" that set out factors to be considered when NERC or a Regional Entity determines the appropriate penalty or remedial action for a violation of a Commission approved Reliability Standard.

13. While requiring specific revisions and clarifications to its enforcement proposal, the Commission accepts NERC's proposed enforcement program. While we have concerns regarding the lack of uniform due process procedures in both the ERO and Regional Entity enforcement programs, we expect these concerns to be addressed when NERC and the Regional Entities submit delegation agreements for our review.

14. ***Pro Forma* Delegation Agreement**: NERC proposes to delegate its enforcement function to Regional Entities throughout North America. Consistent with Order No. 672, NERC's application includes a proposed *pro forma* delegation agreement that contains standard language that will be included in each individual delegation agreement. The proposed *pro forma* agreement would incorporate exhibits, to be customized by the ERO and each Regional Entity in an individual delegation agreement, which addresses such matters as Regional Entity Reliability Standard development procedures and regional enforcement program requirements. The resulting Reliability Standard development procedure and enforcement program provide for the enforcement of Reliability Standards within the geographic boundaries of a Regional Entity.

15. While concerned about the lack of standardized procedures in the *pro forma* delegation agreement, the Commission recognizes the short time frame given to NERC to prepare the proposed agreement. Below, we accept the *pro forma* delegation agreement and, rather than directing NERC to submit revisions in a compliance filing, direct that standardized enforcement procedures and other specific clarifications and revisions be incorporated in the individual delegation agreements. The Commission believes this approach will allow NERC to focus its resources on the negotiation of individual agreements and arrive at the same high level of uniformity contemplated by the Commission in Order No. 672.

I. Background

A. Order No. 672

16. On August 8, 2005, the Energy Policy Act of 2005 (EPAct) was enacted into law. EPAct added section 215 to the FPA.[3] On February 3, 2006, the Commission issued

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

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Order No. 672 to implement the requirements of section 215 of the FPA. Order No. 672 sets forth the process for certifying a single independent ERO, which will be responsible for proposing and enforcing mandatory Reliability Standards subject to the Commission's review and oversight.[4] In addition, Order No. 672 allows the ERO to enter into a delegation agreement with a Regional Entity.[5] Pursuant to a delegation agreement, the ERO may delegate compliance monitoring and enforcement authority and responsibility to a Regional Entity. In addition, a Regional Entity may propose a Reliability Standard to the ERO and, subject to ERO review, the ERO would then submit the proposed Reliability Standard to the Commission for approval. Order No. 672 also allows for the proposal of Reliability Standards that reflect regional differences. A delegation agreement or proposed Reliability Standard must be accepted by the Commission before taking effect. Further, we note that section 215(e)(4)(C) of the FPA allows the Commission to modify such delegation.

17. On March 30, 2006, the Commission issued Order No. 672-A. While generally confirming the Commission's determinations in the Final Rule, Order No. 672-A clarified that the ERO may collect a Commission-approved assessment of dues, fees or charges for all activities performed pursuant to section 215 of the FPA, which would include all activities pursuant to the Commission's regulations.[6]

B. Description of NERC

18. NERC Council is a nonprofit New Jersey corporation whose membership is comprised of the eight regional reliability councils covering the 48 states, several provinces in Canada, and a portion of Baja California Norte.[7]

19. NERC Council has operated as a voluntary, industry-sponsored reliability organization whose mission is to ensure that the Bulk-Power System in North America is reliable, adequate and secure. In response to changes taking place in the electric industry, NERC has promoted the development of a mandatory system of Reliability Standards and

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[4] Order No. 672 at P 31.

[5] A Regional Entity is an entity having enforcement authority pursuant to § 39.8 of the Commission's regulations. 16 U.S.C. § 824o(a)(7); 18 C.F.R. § 39.1, 39.8 (2005).

[6] Order No. 672 at P 65.

[7] The regional reliability councils are Electric Reliability Council of Texas, Inc. (ERCOT), Florida Reliability Coordinating Council (FRCC), Midwest Reliability Organization (MRO), Northeast Power Coordinating Council (NPCC), Reliability First Corporation (RFC), Southeastern Reliability Council (SERC), Southwest Power Pool, Inc. (SPP) and Western Electricity Coordinating Council (WECC).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

compliance. NERC states that its goal is for NERC to become certified and begin operation as the ERO in the United States and Canada, consistent with EPAct and the rules and requirements of the Commission and Canadian provincial regulators.

C. NERC's ERO Certification Application

20. In its April 4, 2006 application, NERC requests that the Commission certify it as the ERO under section 215(c) of the FPA. NERC states that its application includes a comprehensive set of documents defining the structure, governance, and operational procedures of the ERO, and that its application clearly defines the authorities and responsibilities of the ERO, Regional Entities, and the Bulk-Power System users, owners and operators that are within the jurisdiction of the ERO for reliability purposes. NERC states that it has concurrently filed under separate transmittal letter proposed Reliability Standards for separate Commission approval.[8]

21. NERC's ERO application contains a transition plan which is designed to allow NERC Council to continue operating under its present corporate structure for ensuring the reliability of the Bulk-Power System of North America, while it works in parallel to put the ERO structure into place in an affiliate, NERC Corp. Once NERC Corp. is named as the ERO, the existing NERC will be merged into the new corporation and NERC Corp. will be the sole surviving entity. NERC asserts that its members, the existing regional reliability councils, are critical to a successful transition to the ERO. Negotiations must be completed in each of the regions in order to delegate the statutory functions, along with any other functions, that are necessary for NERC to fulfill its responsibilities as an effective ERO. According to NERC, the regional reliability councils have begun to review and revise their existing standard development procedures and compliance programs in preparation for executing delegation agreements with NERC. NERC is working with the regional reliability councils to develop budget and funding processes. Each regional reliability council is working to prepare its exhibits to its delegation agreement.

22. NERC states that it is pursuing recognition individually with the appropriate Canadian provinces and the Canadian National Energy Board. NERC also states that it is exploring recognition by appropriate Mexican authorities on a preliminary basis.[9] NERC

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[8] *See* Docket No. RM06-16-000.

[9] NERC states that it is its understanding that the Comisión Federal de Electricidad, the Mexican government-owned entity that generates, transmits, and distributes most of the electricity in Mexico, has jurisdiction over reliability matters at this time. Legislation has been pending in the Mexican Congress for some time that would give the Comisión Reguladora de Energía jurisdiction over aspects of reliability, however it currently has not been passed.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

states that its certification will result in the formation of an independent, international ERO that will have the authority to develop and enforce Reliability Standards for the North American Bulk-Power System.

II. Notice of Filing, Comments and Answers

23. Notice of filing was published in the Federal Register, 71 Fed. Reg. 19,492 (April 14, 2006), with comments due on or before May 4, 2006. Entities that filed comments are listed and defined in Attachment A to this order. On May 19, 2006, SoCal Edison filed reply comments. On June 9, 2006 WECC filed reply comments. On June 12, 2006, as amended on June 13, 2006, NERC filed reply comments.

III. Procedural Matters

24. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will also grant the untimely motions to intervene given the early stage of this proceeding, the parties' interests, and the absence of any undue burden or delay. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2005), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept SoCal Edison's, WECC's and NERC's reply comments because they have provided information that assisted us in our decisionmaking process.

IV. Discussion

25. Section 215(c) of the FPA establishes the requirements for ERO certification, specifying that the ERO candidate must have the ability to develop and enforce Reliability Standards that provide for an adequate level of reliability of the Bulk-Power System.[10] The statute also requires that the ERO candidate have established Rules[11] that: (1) assure independence, while assuring fair stakeholder representation and balanced decisionmaking; (2) equitably allocate reasonable dues, fees and other charges; (3) provide fair and impartial procedures for enforcing Reliability Standards through imposition of penalties; (4) provide notice and opportunity for public comment, due process and balance in developing Reliability Standards and otherwise exercising its duties; and (5) provide adequate steps to take to gain recognition in Canada and Mexico.

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[10] *See, e.g.*, Order No. 672 at P 129, 156-157.

[11] *Id.* at P 113 & n.80. The ERO Rules and Regional Entity Rules include the Bylaws, the Rules of Procedure and other organizational rules and protocols. These differ from the ERO's continent-wide and regional Reliability Standards that specify requirements for the reliable operation of the Bulk-Power System.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Order No. 672 incorporates these requirements for ERO certification into 18 C.F.R. § 39.3(b). In addition, Order No. 672 specifies other requirements that an ERO must meet.

26. Our discussion of NERC's application to be certified as the ERO is divided into the following sections: (a) governance and decisionmaking; (b) recognition in Canada and Mexico; (c) funding; (d) Reliability Standards; (e) enforcement of Reliability Standards; (f) delegation agreements; (g) Reliability, Adequacy and Other Information; (h) ERO and Regional Entity Rules; (i) compliance registry; (j) ERO and Regional Entity performance assessment; (k) definitions.

27. Over forty comments were filed on NERC's ERO application. Most commenters support NERC being certified by the Commission as the ERO, although many ask that various modifications be made to NERC's proposal. However, Alcoa states that the application fails to meet the requirements established in section 215 of the FPA and Part 39 of the Commission's regulations, particularly with respect to its structure, governance, scope of activities and funding provisions. Consequently, Alcoa requests that the Commission conditionally certify NERC as the ERO, subject to certain modifications to the structure and operations of NERC. FRCC submits that NERC's application is inconsistent with the mandates of section 215 of the FPA, and that were the Commission to approve the application in its current form, the Commission would exceed its authority under the section 215.

A. Governance and Balanced Decisionmaking

28. The Commission's regulations provide that any person may submit an application to the Commission for certification as the ERO within 60 days of the issuance of Order No. 672. The Commission may certify one such applicant as the single ERO, if we determine, among other things, that such applicant has established Rules that assure its independence of users, owners and operators of the Bulk-Power System[12] while assuring fair stakeholder representation in the selection of its directors.

[12] 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.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

1. Board of Trustees

NERC Application

29. NERC proposes a board of trustees consisting of ten independent members, plus the president of NERC Corp. (the management trustee), who shall be elected by the board. Each trustee will have one vote on any matter brought before the board for a vote. The trustees are charged with serving the public interest and representing reliability concerns of the entire North American Bulk-Power System.[13] NERC proposes a formula to allocate membership on the board between trustees from Canada and from the United States,[14] with a provision to add trustees to the board to include at least one trustee from Mexico once NERC receives recognition as Mexico's ERO by the appropriate authorities.

30. The board of trustees is responsible for approving all Reliability Standards, making determinations regarding violations of Reliability Standards and imposing appropriate sanctions, approving delegation agreements with Regional Entities, approving all Rules of Procedure, amendments thereto, and repeals thereof, appointing members of the personnel certification governance committee, fixing compensation paid to independent trustees, and approving the annual budget, business plan, and funding mechanism of the ERO.[15]

31. The Bylaws provide that an independent trustee may not be an officer or employee of NERC or any of its members, or an "officer, director or employee of any entity that would reasonably be perceived as having a direct financial interest in the outcome of board decisions." In addition, an independent trustee may not have a "relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a trustee."[16] Independent trustees serve staggered three-year terms. Prior to each election, a nominating committee recommends candidates for independent trustee positions. The nominating committee consists of the independent trustees whose terms do not expire during the current year "and such number of other persons with such qualifications as the board shall specify," and shall include at least three members from

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[13] ERO Application, exh. B, Bylaws art. III, § 1 (Bylaws).

[14] The number of trustees for both the United States and Canada is determined by taking the percentage of the net energy for load for each country to that of the United States and Canada combined, times eleven, then rounded up to the nearest whole number.

[15] Bylaws arts. IX - XIII.

[16] Bylaws art. III, § 3(a).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the member representatives committee.[17] The board will establish, by resolution, procedures for the nominating committee to identify and recommend candidates, and shall permit members of NERC to recommend candidates to the nominating committee. Nominations shall be consistent with the objective that the board reflect expertise in technical electric operations and reliability, legal, market, financial and regulatory matters, familiarity with regional system operation issues, and geographic diversity. Nominees are elected by a two-thirds vote of the member representatives committee.

Comments

32. As detailed below, commenters have raised a variety of issues regarding the board of trustees, including conflict of interest definitions, current board independence, board compensation, the process for filling board vacancies, and the hold harmless provision in the proposed Bylaws. Each of these issues is detailed below.

33. TAPS states that the Bylaws' definition of "independent trustee," must be clarified to detail what constitutes a "relationship that would interfere with the exercise of independent judgment."[18] As an example, TAPS cites to Order No. 2000's prohibition on employees and board members of a Regional Transmisison Organization (RTO) owning an interest in a market participant.[19]

34. Alcoa states that it is not clear that the proposed process for selecting the ERO's board of trustees would result in an organization that meets the independence requirements in section 215(c)(2)(A) of the FPA. First, although it does not disparage the current members of NERC's board of trustees, Alcoa asserts that NERC has failed to adequately explain the process through which the current board of trustees was elected and has not demonstrated that these individuals are independent. Alcoa is concerned that the present trustees were chosen by the old NERC, prior to certification as the ERO, before it was determined to be independent from users, owners and operators of the Bulk-Power System or that it assured fair stakeholder representation, and before the establishment of the member representatives committee. Alcoa argues that, in order to assure independence, once the ERO is certified, the present board of trustees of NERC should be required to resign and a new board nominated and elected in their place.

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[17] The member representatives committee is discussed further in section IV.A.3, *infra.*

[18] TAPS at 7.

[19] *Id.*, citing *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh'g*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (2000), *aff'd sub nom. Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

35. Several entities question the process for filling board vacancies. Alcoa states that the process for selecting future board members gives rise to concerns regarding the lack of end-user representation in the nominating committee. Both Alcoa and ELCON ask that the number of member representatives committee members on the nominating committee be increased from three to five, with the additional members chosen from representatives of large and small end-use customers.

36. The California Commission and TAPS express concern that only the nominating committee, which is composed mostly of current trustees, can nominate a trustee. In their view, this artificially limits the range of candidates, and could lead to an insulated, self-perpetuating board. California Commission states that, at a minimum, there should be a mechanism to allow ERO members or membership segments to nominate other candidates for election. TAPS proposes that the nominating committee should be revised to include three appointed independent trustees (whose terms are not expiring in the coming year) and three elected members of the member representatives committee, and be chaired by the chairman of the member representatives committee.

37. National Grid is also concerned that the existing trustees will have too much input into how future vacancies are filled. Not only will existing board members potentially outnumber member representatives committee members on the nominating committee by a margin of approximately three-to-one, but the Bylaws also permit the board to select replacement members without using the nominating committee. National Grid recommends amending the Bylaws to include more stakeholders on the nominating committee and to eliminate the provision that permits the board to fill positions without relying on the nominating committee.

38. ELCON also asks that the bylaw calling for the board to establish the compensation for board members should be changed to allow the member representatives committee to determine the compensation of trustees. Allowing the board members to establish their own compensation raises the specter of self-dealing.

NERC Reply Comments

39. In its reply, NERC states that its board will be independent of the users, owners and operators of the Bulk-Power System, and will be elected by a fair cross-section of stakeholders. NERC notes that the proposed process is one that has been in place since NERC moved to an independent board in 2001, and has produced a board of “highly qualified trustees with diverse expertise and experience.” NERC says the proposed Bylaws do not create a “self-perpetuating” board because stakeholders will participate in the selection of nominees and a representative committee of stakeholders will elect independent trustees to the board.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission Conclusion

40. An ERO candidate must document that it has established ERO Rules that assure its independence of the users, owners and operators of the Bulk-Power System while assuring fair stakeholder representation in the selection of its directors.[20] Order No. 672 recognizes that there are a variety of ways in which to provide balanced governance and decisionmaking, and does not mandate a particular approach to governance.[21] Commenters have raised issues regarding NERC's definition of "independence," the independence of the current board, the process for filling board vacancies, and the level of stakeholder involvement in selecting and filling board vacancies. We discuss each of these below.

41. NERC's Bylaws define an independent trustee as follows:

> An independent trustee is a person who is not an officer or employee of the Corporation, a member or an officer, director or employee of a member of the Corporation, or an officer, director, or employee of any entity that would reasonably be perceived as having a direct financial interest in the outcome of board decisions and who does not have a relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a trustee.[[22]]

42. TAPS requests clarification on the definition, urging that NERC follow the example of Order No. 2000's prohibition against RTO employees and board members owning an interest in a market participant. We find that the definition and restrictions are sufficient with one clarification. We ask NERC to confirm that the definition prohibits an independent trustee from having a relationship that would interfere with his or her exercise of independent judgment in carrying out the responsibilities of a trustee, regardless of whether he or she is an officer, director or employee of an entity with an interest in the outcome of board decisions. If that is the case, we believe the definition and restrictions provided by the Bylaws are sufficient.

43. We do not believe the structure as proposed will be self-perpetuating as alleged by commenters. The nomination process is not completely controlled by the existing board as the nominating committee includes at least three members of the member representatives committee and the Bylaws permit members of NERC to recommend candidates to the nominating committee. In addition, nomination is only part of the

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[20] Order No. 672 at P 152.

[21] *Id.*

[22] Bylaws art. III, § 3(a).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

process; the full member representatives committee elects the board. Despite TAPS' concerns that the member representatives committee may be reluctant to vote down a nominee, they have that power if they are dissatisfied with the nominees presented to them. Therefore, we accept the process as proposed by NERC.

44. Alcoa suggests that the current board should be replaced once NERC is certified as the ERO because that is the only way to ensure its independence as required by the statute. According to NERC, the existing structure is essentially the same as the one being proposed for use by the ERO. We believe that the existing NERC processes resulted in an independent board adequate for the transition period. It is important that there be continuity and smooth transition and allowing the current independent NERC board to assume the responsibility of an ERO board is reasonable. Moreover, by 2009, all the board positions will have been filled under the new provisions. Therefore, we will not require that the existing board resign after certification. However, if any sitting board member fails to meet the independence requirements in the Bylaws, as modified in this order, that member must come into compliance with the independence requirements or resign.

45. Further, we do not agree with National Grid that article III, section 4 of the Bylaws allows the board to select replacement trustees without relying on the nominating committee. Rather, it allows for the replacement of a trustee in case of a vacancy at the next annual election or through a special election called by the board. Any such vacancy must still be filled using the nominating committee procedures outlined in the Bylaws.

46. We will not require NERC to change its Rules allowing the board to set compensation for trustees. If members are unhappy with board compensation, they are free to select new trustees as current trustees' terms expire. In addition, the ERO budget is subject to public scrutiny and comment and Commission approval, which will act as a check against unreasonable board compensation.

47. Finally, we believe that appropriate country representation helps to ensure that the ERO is truly international in addressing Bulk-Power System reliability and considering the concerns of stakeholders in each of the three countries.[23] We found in Order No. 672 that it generally 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, and we encouraged ERO candidates to consider such a requirement and explain any departure from such approach in their respective applications. In its Bylaws, NERC proposes international board composition, with a guarantee that the percentage of independent trustees from Canada meets or exceeds the percentage of the net energy for load of

[23] Order No. 672 at P 154.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Canada.[24] There is a similar provision regarding trustees from Mexico that will take effect when NERC receives recognition in Mexico. We find that these provisions adequately provide for an international ERO.

2. General Membership

48. Order No. 672 neither requires nor precludes a particular membership structure.[25] 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 applicant decides to create a membership structure, membership must be open to allow full and fair participation of all interested stakeholders through their representatives.

NERC Application

49. NERC indicates that membership is voluntary and open to any person or entity with an interest in the reliable operation of the North American Bulk-Power System that registers and maintains registration as a member. Under the draft Bylaws, one does not need to be a member of a regional reliability organization[26] or Regional Entity in order to be a member of NERC. Each member chooses to be assigned to one of twelve membership sectors.[27] Membership may be terminated by the board if two-thirds of the board determines, after notice and appropriate due process, that the member has violated its obligations and responsibilities to NERC, which are detailed in article II of the draft Bylaws. Such a termination may be appealed to the Commission or the appropriate authority in Canada or Mexico.

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[24] Bylaws art. III, § 2.

[25] Order No. 672 at P 170.

[26] NERC identifies the regional reliability organizations as the eight existing regional reliability councils that are NERC's existing members. *See supra* n.7.

[27] The sectors are (i) investor-owned utility; (ii) state/municipal utility; (iii) cooperative utility; (iv) federal or provincial utility/federal power marketing administration; (v) transmission-dependent utility; (vi) merchant electricity generator; (vii) electricity marketer; (viii) large end-use electricity customer; (ix) small end-use electricity customer (x) independent system operator/regional transmission organization; (xi) regional reliability organization; or (xii) government representatives. Bylaws art. II, § 4 (a).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

50. Several commenters have concerns with the provision in the Bylaws requiring that each member agree to accept "the responsibility to promote, support, and comply with the purposes and policies of the Corporation as set forth in its Certificate of Incorporation, Bylaws, Rules of Procedures, and Reliability Standards as from time to time adopted, approved, or amended."[28] Alcoa asserts that this provision inappropriately limits dissent by requiring members to fully support each of the ERO's Rules, effectively limiting members' opportunity to complain about Rules or Reliability Standards that they find objectionable or inappropriate. Northern Indiana asks that the provision be revised to clarify that it does not preclude members from seeking modification of existing Reliability Standards or supporting a requested modification.

51. Alcoa, Entergy and TAPS object to the bylaw provision that requires each member to execute an agreement with the ERO that the member will hold all trustees, officers, employees, and agents of the NERC harmless for any injury or damage caused by any act or omission in the course of performance of his or her duties other than acts of fraud.[29] They assert that this agreement restricts members' ability to hold trustees and officers accountable for a breach of the duty of loyalty owed to NERC or an act of bad faith that results in a violation of the law or a personal gain. Alcoa notes that these acts are excluded from the "hold harmless" provision in the twelfth article of the Certificate of Incorporation and that the Bylaws should be made consistent with the Certificate of Incorporation. Entergy points out that the proposed *pro forma* delegation agreement contains a more appropriate limitation on liability that excludes situations involving gross negligence or intentional misconduct. Entergy also asserts that the broad hold harmless clause in the Bylaws is not appropriate where involvement with the ERO is imposed by statute and is inconsistent with the public policy against indemnifying anyone for damages resulting from intentional or willful wrongful acts. According to TAPS, this broad hold harmless agreement required by members may deter stakeholders from becoming members because of the rights they are waiving through membership.

NERC Reply Comments

52. NERC states that commenters are able to seek modification of a Reliability Standard or NERC's Rules of Procedure, citing section 308.1, which allows any person to propose a new or modified Reliability Standard, and Bylaws, article XI, section 2, which permits 50 members representing members from at least three sectors to propose amendment or appeal of existing Rules.

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[28] Bylaws, art. II, § 3(a) (emphasis added); *see also* application at 34.

[29] *Id.*, art. II, § 3(b).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

53. In reply, NERC supports the "hold harmless" clause as necessary to attract high-quality candidates to serve as trustees as well as to attract qualified volunteers to serve on committees, task forces, audit teams and in other critical capacities. Exposure to litigation and liability can discourage qualified candidates, and likewise may discourage employers from permitting employees to volunteer services to NERC. According to NERC, it is relatively easy to file an action alleging "gross negligence" or "intentional misconduct," subjecting trustees or volunteers to expense, distraction, and risk of litigation in cases where the allegations are not proven. NERC states that the "hold harmless" provision does not leave entities without recourse; they always have a right to appeal to the Commission regarding ERO actions adopting or revising Reliability Standards, Bylaws, or Rules of Procedure, or imposing a penalty or sanction. Finally, NERC notes that if these functions were being performed by government employees, the employees would generally be immune from suit and liability for actions or inactions within the scope of their official duties.

Commission Conclusion

54. NERC proposes that membership be available to any person or entity with an interest in the reliable operation of the North American Bulk-Power System, thus creating an open membership structure which is consistent with the statutory requirement that the ERO establish Rules that assure fair stakeholder representation.[30] As there is no fee for membership,[31] financial considerations will not pose a bar to membership. The membership sectors will be addressed in detail in the discussion on the member representatives committee. Although not directly related to openness, two issues have been raised with respect to particular Bylaw provisions and their impact on members.

55. The first issue involves the requirement that members agree to accept "responsibility to promote, support, and comply" with the Certificate of Incorporation, Bylaws, Rules and Procedures, and Reliability Standards. Several commenters voice concern that this provision restricts a member's ability to challenge existing Bylaws, Rules or Reliability Standards. However, if it were read that broadly, there would not be any means for considering or discussing potential amendments to the Bylaws, Rules of Procedure or Reliability Standards. Further, as noted by NERC in its reply, the referenced documents contain provisions regarding amendments, disavowing an intention to stifle dissent or recommendations for change.[32] We do not read the provision to

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[30] Order No. 672 at P 170.

[31] Transmittal Letter at 34.

[32] *See* ERO Application, Exh. A, Certificate of Incorporation art. 11 (Certificate of Incorporation); Bylaws arts. XI, § 2, and XIV; and Rules of Procedure § 1400.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

restrict such dissents; therefore, we do not believe the provision needs to be amended. That said, we do believe that the provision requires members to comply with any provisions that are in effect, which is reasonable.

56. Commenters also take issue with the Bylaws provision requiring that each member sign an agreement holding trustees, officers, employees, and agents of NERC harmless for injuries or damage caused by acts or omissions other than fraud committed in the course of performing their duties. They point out that it requires them to sign an agreement which contains broader hold harmless provision than those in the Certificate of Incorporation, Rules of Procedure, and *pro forma* delegation agreement. NERC responds that such a provision is needed to attract qualified trustees and volunteers who may decline to serve if they will be subject to actions based on vague allegations such as gross negligence or intentional misconduct. We share NERC's concern that potential trustees and volunteers may be discouraged by the prospect of having to expend time and money defending against such suits. Given that an entity who feels it has been aggrieved by the action of such individuals may appeal such actions to the Commission, we think the hold harmless provision in the Bylaws is acceptable.

3. Member Representatives Committee and Registered Ballot Body

57. Under NERC's application, there are two major voting bodies in addition to the board – the member representatives committee and the registered ballot body. NERC proposes the member representatives committee in place of the current stakeholder committee. The member representatives committee will elect the independent trustees, vote on amendments to the Bylaws (jointly with the board), and advise the board with respect to development of the budget, business plans and funding mechanisms, and other matters.[33] The registered ballot body will vote on Reliability Standards prior to submittal to the board.

a. Lack of Consistency Among Member Representatives Committee Sectors and Registered Ballot Body Segments

NERC Application

58. The member representatives committee consists of: (i) two representatives from each of the twelve membership sectors except the government representative sector and the regional reliability organization sector; (ii) one representative from each regional reliability organization; (iii) the chairman and vice chairman of the member representatives committee; (iv) any additional Canadian representatives that are selected pursuant to the provisions regarding adequate representation of Canadian interests on the

[33] Transmittal Letter at 38; Bylaws art. VIII, § 1.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

member representatives committee;[34] and (v) the following government representatives: two non-voting representatives of the United States federal government, one non-voting representative of the Canadian federal government, two voting representatives of state governments, and one non-voting representative of a provincial government. The registered ballot body segments are as follows: (1) transmission owners; (2) RTOs, independent system operators (ISOs), and regional reliability organizations; (3) load-serving entities; (4) transmission dependent utilities; (5) electric generators; (6) electricity brokers, aggregators, and marketers; (7) large electricity end users; (8) small electricity users; and (9) federal, state, and provincial regulators or other government entities. The registered ballot body votes by segments, while the member representatives committee does not.[35]

Comments

59. Several commenters note the discrepancy between voting groups comprising the member representatives committee and the registered ballot body. Some approve of the differences; many do not. This section includes comments relating to the differences between the two groups. Comments on the composition of the individual groups are discussed in separate discussions below.

60. APPA supports NERC's proposal to retain the function-based, nine-segment registered ballot body model for the development and approval of Reliability Standards, while carrying forward largely unchanged the twelve-segment design now used for the stakeholders committee for the purposes of membership in NERC and election of members of the member representatives committee. APPA opposes any suggestion to increase the voting strength of Regional Entities or other regional interests.

61. Several other commenters are concerned with the lack of consistent stakeholder groups between the member representatives committee and the registered ballot body sectors. Commenters note that NERC has not provided a reasonable rationale for establishing two different sets of sectors/segments.[36] ELCON states that having two

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[34] The Bylaws provide for a representative number of Canadian voting representatives on the member representatives committee in proportion to Canada's percentage of net energy for load. If insufficient representatives are elected through the usual process, the Canadian candidates with the greatest number of votes will be added to the member representatives committee; however, no more than one Canadian representative will be added from a sector. Bylaws art. VIII, § 4.

[35] Rules of Procedure § 305.5; Rules of Procedure app. 1 at 19; Bylaws art. VII, § 9.

[36] *See, e.g.*, NARUC at 8.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

voting bodies, with two different methods of allocating votes, is unnecessary, confusing, inefficient, costly, and potentially discriminatory to the extent that the two groups would not, by design, vote the same way on any given matter. ELCON states that it would prefer the nine sector registered ballot body approach to be used in the member representatives committee, as it has been demonstrated to work well, whereas the twelve sector approach would significantly reduce the representation of end-use customers and skew it towards owners and operators of the Bulk-Power System and the regions. NARUC also favors a smaller number of divisions, stating that having 12 sectors dilutes the vote of regulators.

62. The California ISO and the ISO/RTO Council contend that the different treatment of ISOs and RTOs in the member representatives committee and the registered ballot body is arbitrary, unreasonable, and inconsistent with the intent of EPAct. ISOs and RTOs are treated as a separate industry segment for purposes of representation on the member representatives committee; however, without explanation, they are combined into the same industry segment as regional reliability organizations and Regional Entities for purposes of the registered ballot body developing and voting on Reliability Standards.

Commission Conclusion

63. We share commenters' concern that NERC has proposed two different voting bodies with distinct differences in stakeholder composition without adequate justification for the differences in treatment. We will defer a decision on the proposed voting structures and direct NERC to make a compliance filing to explain why it is necessary or appropriate to have different voting bodies. Without greater justification by NERC, it is our preference that the two voting bodies share a consistent structure.

b. Member Representatives Committee Composition and Voting

NERC Application

64. The member representatives committee will elect the independent trustees, vote on amendments to the Bylaws (jointly with the board), and advise the board with respect to development of the budget, business plan and funding mechanisms, and other matters. It also appears that the member representatives committee will have an advisory role to the board with respect to proposed Reliability Standards as well.[37]

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[37] *See* Transmittal Letter at 48; Rules of Procedure, app. 1 at 7 ("The NERC Members Committee shall advise the Board of Trustees on Reliability Standards presented for adoption by the board.") and 20 ("The board shall consider any advice offered by the NERC Stakeholders Committee."). The Commission notes that step 10 refers to the current NERC Stakeholders Committee. We assume that NERC intended this to be the member representatives committee and require NERC to clarify this in its

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

65. Only one officer, employee, agent or representative of a member in a sector may be a representative from that sector at any time. Members of the board of trustees are not eligible to be members of the member representatives committee. Representatives to the member representatives committee serve two-year terms staggered so that approximately half expire each year.

66. The member representatives committee selects a chairman and vice chairman from among its voting members annually prior to the election of new representatives. The chairman and vice chairman cannot come from the same sector, and shall each have at least one year remaining on their terms. Once individuals are elected as chairman and vice chairman, they no longer act as representative of a sector, and are to act in the best interests of the members as a whole.

Comments

67. Several commenters have raised issues regarding the composition of the member representatives committee, particularly with respect to regional reliability organization participation. Issues primarily involve whether regional reliability organizations should be voting members of the member representatives committee and, if so, should they have eight votes as proposed, or be limited to fewer votes.

68. Commenters raise a threshold issue regarding the relationship between the regional reliability organizations and the Regional Entities, and want NERC to address the relationship.[38] Constellation presumes that there will be significant overlap between the two, and requests that NERC clarify if it intends to maintain a distinction between the two and, if so, why it believes such a distinction is necessary, the effects of the distinction, and how it will address member representatives committee representation between these two types of entities to the extent they overlap. As detailed below, many commenters assume some degree of overlap between the regional reliability organizations and the Regional Entities.

69. Commenters assert that the voting allocation in the member representatives committee is not balanced, with the regional reliability organizations having eight out of approximately 32 votes. Constellation maintains that this arrangement raises serious questions about the independence of the ERO and the requirement that the member representatives committee decisionmaking process be fair and balanced. Alcoa notes that the strong presence of regional reliability organizations on the member representatives committee belies the notion that the regional reliability organizations are to be

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compliance filing.

[38] *See, e.g.*, Constellation at 6; Georgia Operators at 11-12.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

subordinate to the ERO, given that the regional reliability organizations are expected to become the Regional Entities which will receive delegated authority from the ERO to propose and enforce Reliability Standards.

70. Other commenters raise concerns with respect to potential conflicts with the regional reliability presence on the member representatives committee. California Cogeneration argues that, because the Regional Entities receive their authority and funding from NERC, they cannot be independent members of the committee. Similarly, Constellation is concerned about regional reliability organization influence on the member representatives committee, which has the obligation to advise the ERO on matters that may include issues relating to duties delegated to the Regional Entities.

71. Alcoa and Constellation suggest that the regional reliability organizations could be non-voting members. At a minimum, Constellation asks that the Commission order NERC to reduce the regional reliability organization sector representation to be equivalent to other sector percentages on the member representatives committee.

72. PG&E believes that each Interconnection should have a proportionate voice in the ERO decisionmaking process, with no single Interconnection dominating that process. Specifically, PG&E is concerned that the influence of entities in the Western Interconnection will be diluted because there are fewer entities than in other Interconnections, even though the entities in the Western Interconnection may be serving significantly greater load. According to PG&E, this affects the Western Interconnection entities' opportunity to elect representatives, which impairs their ability to participate in the ERO decisionmaking process. PG&E believes that this imbalance could prevent any members from Western Interconnection entities from being elected to a committee, and proposes that the Western Interconnection be guaranteed a minimum number of representatives on ERO committees based upon the percentage of load it serves.

73. Alcoa asserts that the basis upon which member representatives committee representatives will be selected for each sector is unclear. It raises concerns about whether affiliates can populate different sectors of the committee and that no corporate family should be allowed more than one vote, and contends that elimination of these concerns is necessary to ensure fair and balanced stakeholder representation. Alcoa maintains that the Bylaws permit the chairman and vice chairman of the member representatives committee to be voting members, which Alcoa states appears to improperly provide their respective sectors with an additional vote.

NERC Reply Comments

74. NERC disagrees that it should remove the term "regional reliability organization" from the Bylaws and Rules of Procedure as duplicative of the term "Regional Entity." NERC states that it intentionally used each term, and that "regional reliability organization" refers to existing regional reliability councils, which have specific

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

responsibilities with respect to Reliability Standards. In contrast, "Regional Entity" refers to an entity with regional enforcement authority under the terms of a delegation agreement with NERC or through direct assignment by the Commission. NERC notes that, while it is assumed that each of the eight existing regional reliability councils will seek to become "Regional Entities," this may not actually happen in all cases, citing one example where a regional reliability council is contemplating formation of a separate legal entity to function as the "Regional Entity."

Commission Conclusion

75. As discussed above, we are not prepared to approve the structure of the member representatives committee until NERC has made its compliance filing addressing whether the member representatives committee should contain different sectors than the registered ballot body. That said, we do have some specific concerns with regard to the proposed structure of the member representatives committee, particularly with respect to participation by the regional reliability organizations. If any regional group is to be represented on the member representatives committee, we require it to also include the Regional Entities, which have a direct role in the functions provided by the ERO under section 215, as well as the regional reliability organizations. The Commission is concerned that the regions, both the regional reliability organizations and the Regional Entities, have a disproportionate vote on the member representative committee – representing approximately 25 percent of the votes. We believe that providing for one participant from each Interconnection from either the regional reliability organizations or the Regional Entities is sufficient to ensure that each Interconnection is adequately represented. The member from the Eastern Interconnection should be voted on by the members of that Interconnection. As part of its compliance filing, NERC should address commenters' other concerns regarding participation by Regional Entities. In particular, NERC should address the potential conflict in having Regional Entities participate in advising the board on issues such as budgets, which will have a direct impact on the Regional Entities.

76. We agree with commenters that the relationship between the regional reliability organizations and the Regional Entities is important. NERC's attempt to clarify the relationship in its reply comments does not adequately address all of the relevant issues. Therefore, we direct NERC to explain in greater detail the relationships between regional reliability organizations and Regional Entities.[39] As part of its explanation, NERC should include clarification about the following issues: (1) the extent to which management of the organizations may overlap; (2) the functions expected to be performed by each

[39] We understand that NERC may not be able to provide complete details on the distinction between the regional reliability organizations and the Regional Entities until their roles are completely defined. We expect NERC to provide these details no later than the time when it files the individual delegation agreements.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

organization and whether they overlap, (for example, is the Regional Entity performing statutory functions exclusively, and the regional reliability organization performing non-statutory functions exclusively?); (3) any expected shared resources, facilities or personnel between organizations; (4) the extent to which the Regional Entity may be affected by actions taken by the regional reliability organization; (5) their respective roles in the Reliability Standard development and implementation process; and (6) any other clarifications that would be helpful for the Commission to understand the distinction between the two organizations and their respective duties.

77. As for Alcoa's concern regarding members of the same corporate family populating different sectors of the member representatives committee, our reading is that the Bylaws permit this. Although the Bylaws say that only one officer, employee, agent or representative of a member company may be a representative of a particular sector, that only appears to prevent both representatives of a particular sector from being from the same company; it does not prevent two employees of a particular company (that fits the membership criteria of more than one sector) from representing two different sectors in the member representatives committee. While NERC may want to consider such a limitation, we will not impose one because members may always prevent or cure a perceived imbalance by not electing more than one representative from a single entity or corporate family. If NERC intends to prevent two affiliates of the same company from populating a single sector, it should clarify the Bylaws, as they currently seem to permit such representation. We do not think that NERC's proposal to allow the chairman and vice-chairman to be voting members of the member representatives committee poses an imbalance as they are charged with representing the interests of the members as a whole. In any event, a new chairman is elected each year, minimizing the influence of any one sector over time.

c. Registered Ballot Body Composition and Voting

NERC Application

78. The registered ballot body votes on draft Reliability Standards before they are submitted to the board for approval. The registered ballot body consists of any person or entity with a legitimate interest in the reliability of the Bulk-Power System, regardless of whether they are a member of the ERO. As stated above, there are nine segments in which a participant may be a member and participants in the ballot body may be members of more than one ballot body segment. An agent may hold an unlimited number of proxies for voting in a segment. However, an organization may be represented by only one individual in each segment, and that individual may not represent an organization in more than one segment.[40]

[40] Rules of Procedure § 3.5.3.1.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

79. International Transmission argues in favor of requiring that one of the representatives of the transmission owning segment of the standards committee[41] be from an independent transmission company because they do not have to balance other competing interests in evaluating proposed Reliability Standards, which gives them an important voice in advocating for stronger Reliability Standards.

80. There were numerous comments filed regarding balance in the registered ballot body. For instance, FRCC alleges that it is not balanced among the segments because the number of members within each segment varies dramatically.[42] Although some of the smaller segments bear the costs of Reliability Standards, they are not subject to compliance with the Reliability Standards.[43] Northern Indiana indicates that segments that are not subject to Reliability Standards may be more likely to vote for a Reliability Standard without a full cost-benefit analysis. Georgia Operators urges that the segments of the registered ballot body should expressly include each of the types of functional entities included in NERC's proposed compliance registry process because they will be the ones who have to comply with the Reliability Standards.[44] Georgia Operators is particularly concerned that there is no segment that includes any of the three types of functional entities requiring ERO certification under NERC's Organization Registration and Certification Manual, namely balancing authorities, transmission operators, and reliability coordinators. Georgia Operators suggests that those three functional entities

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[41] Under NERC's proposed development procedures, the standards committee will appoint a Reliability Standards drafting team with the necessary technical expertise, competencies, and diversity of views to draft Reliability Standards based on sound engineering and technical criteria using actual data and lessons learned from operating incidents.

[42] According to FRCC, segments 7 (large end-use customers), 8 (small end-use customers) and 9 (regulators or other government entities) account for only nine percent of registered members, but control one third of the vote.

[43] Georgia Operators at 7; Northern Indiana at 3.

[44] Georgia Operators at 5. The responsible entities are: reliability coordinators, balancing authorities, transmission operators, transmission owners, generator operators, generator owners, transmission service providers, planning authorities, transmission planners, resource planners, load-serving entities, purchasing-selling entities, and distribution providers. Rules of Procedure § 501.1.1. According to Georgia Operators, currently only transmission owners, load-serving entities, generation owners, generation operators and purchasing-selling entities are eligible to join any of the existing segments.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

could be added to existing segment 2 (RTOs, ISOs and regional reliability organizations), given that section 202.16 of the Rules of Procedure defines all of them as "system operators." Alternatively, new segments could be created for each of the three.

81. California ISO and the ISO/RTO Council assert that there are compelling reasons why ISOs and RTOs should not be grouped with regional reliability organizations and Regional Entities for purposes of the registered ballot bodies and standards committee. First, they argue that the two groups perform different functions; ISOs and RTOs are required to implement and comply with approved Reliability Standards, whereas Regional Entities set and enforce those standards. Second, NERC's proposal does not assure balanced decisionmaking and provide for balance of interests in developing Reliability Standards because the ISOs and RTOs' unique interests and positions may not be reflected in the final vote of the registered ballot body or standards committee or their vote may be unfairly diluted. The California ISO asserts that, given the amount of electricity delivered by ISOs and RTOs and the total miles of high voltage transmission lines overseen by ISOs and RTOs, failing to treat ISOs and RTOs as a separate segment in the registered ballot body or the standards committee violates the requirements for balanced decisionmaking. Third, the California ISO asserts that both section 215 of the FPA and Order No. 672 support treating ISOs and RTOs as a separate industry segment because both recognize ISOs and RTOs as separate entities with distinct responsibilities with respect to Reliability Standards.

82. International Transmission and National Grid have concerns with the provision allowing an entity to join multiple registered ballot body segments, which it states could "inflate the influence of companies that are eligible to join multiple segments . . . conceivably entitling some entities to more than one vote in the ballot pool." Adding to its concern is the proposal that the standards committee consist of two members from each registered ballot body segment. International Transmission proposes that an entity be eligible for election to the standards committee as the representative of no more than one registered ballot body segment.

83. Although APPA supports the proposition that an entity can only be a member in one membership segment, it proposes that members of the NERC registered ballot body self-nominate based on their technical expertise and their ability to represent a specific functional interest of the entities being represented in the standards development process. APPA notes that NERC's proposal to automatically register members of the registered ballot body as members of NERC will not work, since the nine registered ballot body segments do not map directly to the twelve NERC corporate segments used for membership and entities are generally allowed to join multiple ballot body segments of the registered ballot body. It therefore asks the Commission to direct NERC to modify its Bylaws to provide that NERC will invite each entity that becomes a member of the registered ballot body to nominate a single representative to become a member of NERC.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

84. TAPS raises an issue regarding inconsistencies in the definition of "transmission dependent utilities" as defined in the Bylaws and in the Rules of Procedure (defining the registered ballot body segments). The Bylaws define transmission dependent utilities to include entities serving wholesale customers,[45] while section 305.5.4 of the Rules of Procedure does not, which may result in exclusion of joint action agencies and generation and transmission cooperatives in the ballot body segment for transmission dependent utilities. TAPS requests that the Commission require NERC to modify the definition of "transmission dependent utilities" in the Rules of Procedure to match the definition in the Bylaws.

85. National Grid advocates across-the-board minimum ownership criteria to participate in the transmission owner segment. Currently there is a proposed minimum threshold (200 circuit miles of transmission) for transmission owners that are not in an ISO/RTO region, but no threshold for independent transmission companies, merchant transmission companies, non-RTO transcos, or those in RTO regions. National Grid advocates limiting participation in the transmission owners segment across the board to those entities who own at least 200 circuit miles of transmission.

NERC Reply Comments

86. NERC asserts that the issues raised by commenters concerning the composition of the registered ballot body were raised by various stakeholders in their comments as NERC was revising its standards development process in anticipation of passage of EPAct.

87. It asserts that, while there are a number of different ways of subdividing industry for purposes of balloting proposed standards, its proposed composition of the registered ballot body assures that all entities with an interest in Reliability Standards will have a fair opportunity to participate in the development and voting processes and that no single entity or single interest can dominate the process, and this satisfies the statutory requirements for a balance of interests. Further, NERC asserts that its proposed registered ballot body structure has the support of a large majority of NERC's stakeholders. In addition, NERC asserts that the nine-segment, weighted-voting registered ballot body model has worked well to produce a sound body of Reliability Standards.

88. Finally, NERC contends that if experience indicates that a change in the composition of the registered ballot body is necessary, there are two ways it can be

[45] Bylaws art. II, § 4(1)(v).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

changed: the NERC board can, subject to obtaining Commission approval, adjust the segments, or stakeholders may propose changes to the composition of the registered ballot body through the Reliability Standard development process.[46]

Commission Conclusion

89. With respect to the comments on achieving balance, we are not prepared at this time to direct precisely how NERC achieves balance in the ballot body. We agree with NERC that there are any number of ways that the groups could be divided without disrupting balance. Some argue that too much weight is given to those who pay for the program, while others argue that not enough weight is given to those who pay for the system. The fact that complaints are coming from both directions and that this proposal is supported by the majority of NERC's stakeholders suggest that the voting allocation is not unfairly balanced in any one direction. However, we find that there are some areas that warrant further examination.

90. Given Georgia Operators' concern that there may be instances where balancing authorities, transmission operators, and reliability coordinators do not fit within an existing segment, we direct NERC to explain how the views of these entities, which are subject to ERO certification, will be taken into account in establishing Reliability Standards, or to explain why their participation is not necessary to the process in its compliance filing. We agree with the California ISO and the ISO/RTO Council that the unique interests of ISOs and RTOs are not adequately represented when combined in a single segment with Regional Entities and regional reliability organizations. Therefore, we require NERC to create a separate segment for ISOs and RTOs and address the ISO/RTO Council's request for a waiver from the provision weighting the vote of segments with fewer than ten members. Alternatively, NERC may propose and justify an alternative approach. Further, similar to our treatment of the member representatives committee, we believe that, in addition to the regional reliability organizations, the Regional Entities should also be represented on the registered ballot body. We also direct NERC to address the concerns raised regarding an entity's ability to belong to multiple ballot body segments, and the potential for such provision to permit some companies multiple voices in the ballot pool.

91. NERC's compliance filing must address the concerns raised by APPA regarding NERC's proposal to automatically register members of the registered ballot body as NERC members. In addition, NERC must address how it proposes to automatically register entities when membership in NERC imposes certain obligations, such as the provisions found in Bylaws, article II, § 3.

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[46] We note that the Commission may also order a charge if we find that the structure has proven not to comply with the FPA or the Commission's regulations.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

92. We agree with TAPS that the definition of "transmission-dependent utilities" in the Bylaws and Rules of Procedure should be consistent. We direct NERC in its compliance filing to amend the Rules of Procedure to mach the broader definition in the Bylaws. NERC should fully explain or justify whichever definition is chosen.

93. We understand National Grid's concern regarding why there is a minimum ownership threshold for transmission entities that are not in an ISO/RTO region, but not one for those in an ISO/RTO region. However, we are concerned not only that similar entities be treated in a similar manner, but also that all interested persons be given an opportunity to participate. We do not understand how the minimum ownership requirement comports with inclusiveness. Therefore, we direct NERC to address whether (and why) a minimum ownership threshold is appropriate, and if so, explain why it is only appropriate for entities that are not in an ISO/RTO region in its compliance filing. Alternatively, NERC's compliance filing could opt to remove the minimum ownership threshold from section 305.5.1. We also note that there appears to be an omission at the end of section 305.1.4, which probably means to state "they are eligible to join Segment 2." NERC is directed to correct that omission in its compliance filing.

4. Other Committees

NERC Application

94. NERC's Bylaws permit the board to create standing committees, subcommittees, task forces, and sector-specific forums as the board deems necessary. The board is directed to appoint committees "that are representative of members, other interested parties and the public, that provide for balanced decisionmaking, and that include persons with outstanding technical knowledge and experience."[47] All committee appointments shall include an equitable number of members from the United States and Canada (and from Mexico after the ERO is recognized by appropriate Mexican officials) based upon approximate proportion of that country's percentage of the total net energy for load.

95. In addition to the member representatives committee and the personnel certification governance committee, NERC committees include the standards committee, the compliance and certification committee, and the critical infrastructure protection committee, and operating and planning committees and subgroups. The standards committee includes two representatives of each segment of the registered ballot body.

Comments

96. TAPS states that section 1302 of the Rules of Procedure, which allows for committees to obtain balanced decisionmaking by either providing for participation by

[47] *Id.* art. VII, § 1.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

representatives of each sector or "by bringing together a wide diversity of opinions from industry experts with outstanding technical knowledge and experience in the subject area," violates Order No. 672's requirement for balanced decisionmaking in committees or other subordinate structures.[48] It also limits application of the "no-one-sector-controls/no-two-may-veto" requirement to committees established on a sector basis. This permits the ERO to form committees that do not meet Order No. 672's requirement for balance. TAPS is concerned that the application does not discuss this deviation, and instead focuses on NERC's effectiveness in obtaining industry expertise in its standards development process and committee structure. TAPS points out that such experts often are affiliated with a particular industry sector, and that even non-affiliated experts' views may be influenced by clients that they typically represent. According to TAPS, solicitation of expert opinion cannot replace the statutory requirement for balanced decisionmaking. Instead, TAPS proposes that NERC secure expert input through expert task forces that report to a balanced committee or subcommittee.

97. TAPS also voices concern that NERC seems to deviate from the "no-one-sector-controls/no-two-may-veto" balance requirement when it comes to Reliability Standard development. In particular, section 311.3.1.3 of the Rules of Procedure states that "[t]he regional Reliability Standards development procedure shall have a balance of interests and shall not be dominated by any single interest category." TAPS urges the Commission to require NERC to consistently apply a "no-one-sector-controls/no-two-may-veto" rule in all contexts, including standards development.

98. Ameren requests that NERC provide additional information about the compliance and certification committee, which will hear disputes over findings of noncompliance and the imposition of penalties against a Regional Entity, claiming that NERC has not provided an adequate explanation of the proposed membership, scope or charter for this committee. Ameren notes that NERC has provided considerable detail regarding other committees and should provide similar detail about the compliance and certification committee.

99. ELCON and Bonneville advocate that the technical standing committees should be consolidated into a single technical advisory committee. In particular, ELCON asserts that preserving the operating committee and the planning committee would duplicate the efforts of the six program committees, and keeping the operating committee and the planning committee as they currently exist sends the signal of "business as usual" and asks that these two committees be abolished and replaced with a technical advisory committee that acts as an advisor to the six program committees.

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[48] TAPS at 12, citing Order No. 672 at P 153.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

100. Under NERC's proposed Reliability Standard development process, a standard is first approved by a registered ballot body and then submitted to the NERC board for approval. Bonneville asserts that NERC should provide for a separate body of technical experts, balanced by industry segment, to evaluate all proposed standards, engage in discussion and debate regarding the standards, and make recommendations to the ballot pool and the board. Bonneville recommends that this body be formed from the existing planning and operating committee or have comparable expertise. Bonneville asserts that the submission and exchange of comments does not offer the same value as dialogue among experts in making decisions on proposed Reliability Standards.

NERC Reply Comments

101. With regard to the comment suggesting that NERC's application does not meet the "balanced decisionmaking" requirement of section 215, because that criterion does not apply to all committees, NERC responds that art. VII, sec. 1 of its proposed Bylaws categorically address and comply with this statutory requirement.[49]

102. On the various suggestions for changes in how NERC's committees are structured, such as by combining the standing committees into a single technical advisory committee advocated by ELCON and Bonneville, NERC claims that these are issues for further consideration by NERC (with, of course, stakeholder input), not the Commission, and in any event are not relevant to whether NERC should be certified as the ERO. The goals, responsibilities and accountabilities, membership, and organization and procedures of the NERC committees are currently under active review.[50]

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[49] NERC points out that its Bylaws state: "The board shall appoint standing committees and other committees of the Corporation that are representative of members, other interested parties and the public, that provide for balanced decisionmaking, and that include persons with outstanding technical knowledge and experience."

[50] NERC notes that, at a special Board meeting held on March 28, 2006 to approve the filing of NERC's ERO application, many stakeholders as well as trustees stated that the NERC operating committee and planning committee were critical to NERC's success. Many stakeholders asked that NERC not rush to change the committee structures or membership. Some suggested waiting for at least two years after NERC is certified as the ERO, while others thought 12 months would be more appropriate. Thus, NERC expects the board to take action on new committee charters in 2007. In its view, the committee charters and structures will need to evolve as NERC establishes itself as the ERO and identifies its needs for the committees. The issues raised by commenters regarding committee structures can be addressed in the context of those revised committee charters.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

103. NERC agrees with the commenters who state that NERC committees must be open. NERC notes that it has included such a requirement in its proposed section 1304 of the Rules of Procedure. As noted in that provision, however, there are circumstances in which a committee meeting would be properly held in closed session.

Commission Conclusion

104. We do not believe that NERC's proposal to structure committees with either sector representatives or diverse industry experts necessarily violates the concept of balanced decisionmaking. Although TAPS is concerned that experts often are affiliated with particular industry sectors, NERC can and should take such relationships into account when structuring and approving committees. Generally, committee appointments require board approval, which should help ensure balanced committees.

105. However, we do share TAPS' concern that the Rules of Procedure only specifies that "[c]ommittees that are established on a sector basis must ensure that no two stakeholder sectors are able to control the vote . . . , and no single sector is able to defeat a matter."[51] Order No. 672 requires 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 … unless the ERO adequately explains why it cannot apply these principles."[52] Section 1302 of the Rules of Procedure appears to allow a single sector to control the vote in a committee, or other sub-organizational structure, which is not established on a sector basis. NERC's proposal is not consistent with Order No. 672. We agree with TAPS that NERC has not justified the deviation in section 311.3.1.3 of the Rules of Procedure, which states that the regional Reliability Standard development procedure may not be dominated by any single interest category, from our directive to the extent that it permits two interest categories or sectors to control the vote. Therefore, in its compliance filing, NERC must correct these non-compliant provisions in its Rules of Procedure.

106. With regard to Ameren's request for additional information about membership, scope and charter for other committees, we do not believe that such details are required in the application. As long as the ERO's Rules for committees comply with our regulations, and they follow those Rules, that should suffice.

107. ELCON and Bonneville recommend consolidating technical standing committees. However, neither has alleged that the proposed structure violates our regulations. Accordingly, we agree with NERC's assessment that those are issues best decided by NERC; therefore we decline to direct how NERC should structure its technical

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[51] Rules of Procedure § 1302.

[52] Order No. 672 at P 153.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

committees. Similarly, we do not adopt Bonneville's recommendation that NERC have a separate body of technical experts to review and debate Reliability Standards and make recommendations to the ballot body and the board as part of its Reliability Standards development process. While NERC may consider the merits of Bonneville's proposal, we will not compel such an approach.

5. Meetings and Voting

NERC Application

Board of Trustees Meetings

108. According to NERC's draft Bylaws, meetings may be called by the chairman of the board or by a group consisting of at least ten percent of the membership and representing at least three sectors of membership. The secretary of the NERC will give written notice to all members 10-60 days before a meeting.[53]

109. The draft Bylaws permit action by the board or a committee of the board without an actual meeting of the members where the action is consented to in writing by the minimum number of members that would be required to approve it at a meeting at which all members were present. The call for action without a meeting may be initiated by the chairman of the board or by a group of members consisting of at least ten percent of the membership and representing at least three sectors of membership. Notice of the proposal for action will be provided to all members at least ten days prior to the date for tabulating results.

110. The draft Bylaws specify that meetings of the members will be open to the public, subject to accommodations, unless matters of a confidential nature are going to be discussed. NERC will provide notice of the date, place and times of meetings, as well as all non-confidential material provided to the members on its website at approximately the same time notice is given to members (10-60 days before a meeting).

111. Pursuant to NERC's draft Bylaws, the board will have a regular meeting around February 1 each year, and may elect to have additional regular meetings. The chairman or any two trustees may call special meetings of the board, with at least five days prior notice. As with member meetings, board meetings are open to the public, subject to accommodations, but may be closed to discuss matters of a confidential nature.

Member Representatives Committee Meetings

112. The member representatives committee has an annual meeting for the election of

[53] Bylaws art. IV, § 1.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

independent trustees and to conduct any other business. They may, by resolution, provide for additional regular meetings that may be held without notice.[54] Special meetings of the member representatives committee may be called by the chair or by any five members representing at least three sectors upon seven days prior notice.

113. Meetings of the member representatives committee shall be public subject to space availability, unless a session is closed to discuss matters of a confidential nature. Public notice of meetings will be provided, and copies of all non-confidential material made available to representatives will be publicly available on the ERO's website.

114. Action may be taken by the member representatives committee without a meeting where consented to in writing by the number of voting members required to approve the action at a meeting with all members present. The chair or a group of five or more members representing three or more sectors may call for action without a meeting.

115. The Bylaws may be amended or repealed by a majority vote by both the board of trustees and the member representatives committee with quorums present. In addition, members of NERC, voting by sector can amend or appeal the Bylaws or adopt new Bylaws with approval by vote of two-thirds of the sectors. The voting will be in accordance with the rules above for votes of the full membership.

Comments

Board of Trustees Meetings

116. Bonneville states that having the board of trustees meetings open is critical to better decisionmaking and will enable all parties to better understand board decisions. It states that although the Bylaws require board meetings to be open, the board has virtually unlimited power to delegate its authority to committees. Bonneville argues that much of the board's operational activities could end up being performed by committees because it only needs to say that the committee is necessary for the board to perform its responsibilities, and the committee's duties are "such duties as are prescribed by the board."[55] Bonneville therefore argues that it is unclear how much board business will be conducted openly and asks that the Commission require that committee meetings also be subject to the open meeting requirement.

117. Bonneville further argues that article V, section 6 of the Bylaws negates the open meetings requirement by allowing both the board and committees to take any action without a meeting by consenting to the action in writing. It argues that the right to make

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[54] *Id.* art. VIII, § 7.

[55] *Id* art. III, § 8.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

decisions by written consent should be limited to ministerial actions, actions requiring confidentiality, and actions requiring urgency for which there is inadequate time to provide notice and hold a meeting.

118. Bonneville protests the provision that the board must post notice of each meeting and send meeting materials to members at "approximately" the same time as the board receives notice or materials, which it claims allow for unspecified delay and is subject to abuse. It asks that the Commission require the board to provide notice and materials to members or the public at the same time as it receives the notice or materials.

119. Bonneville also notes that sections one and four of article V of the Bylaws are inconsistent. Section one allows the board to set regular meetings other than annual meetings and to hold them without notice, whereas section four requires notice of all board meetings. Bonneville advocates elimination of the provision permitting regular meetings without notice.

Member Representative Committee Meetings

120. Bonneville states that having open meetings of the member representatives committee is critical. Bonneville states that, similar to the powers held by the board of trustees, the Bylaws allow the member representatives committee to take any action without a meeting by consenting to the action in writing. It again argues that the right to make decisions by written consent should be limited to ministerial actions, actions requiring confidentiality, and actions requiring urgency for which there is inadequate time to provide notice and hold a meeting. Also similar to the board of trustees, section 7 of article VIII of the Bylaws allows the member representatives committee to set regular meetings other than annual meetings and to hold them without notice whereas section ten requires notice of all member representatives committee meetings. Bonneville requests that the Commission require all member representatives committee meetings to be noticed. Finally, Bonneville requests that the Commission require the member representatives committee to provide notice and materials to members or the public at the same time as it receives the notice or materials.

NERC Reply Comments

121. NERC states that its Bylaw provision permitting the board to establish meetings to be held without notice is common in corporate bylaws, and allows the board to establish a schedule of meetings that may take place in the future without notice of each meeting being provided to the trustees. NERC agrees that notice of all board meetings should be given to the members and the public via posting on the NERC website and electronic notice to members, and that materials provided to the board should be posted on NERC's website, subject to limitations for non-public information. NERC claims that such notice is provided for in sections four and six of article five of the Bylaws.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission Conclusion

122. Bonneville raises concerns that the board will transfer duties to committees, and questions whether that will affect the openness of board business. We note that, similar to the provisions regarding openness of board meetings, section 1304.1 of the Rules of Procedure specifies that "[m]eetings of all standing committees shall be open to the public, subject to reasonable limitations due to the availability and size of meeting facilities; provided that the meeting may be held in or adjourn to closed session to discuss matters of a confidential nature . . . ." However, this provision only addresses standing committees. We require that NERC modify its Rules of Procedure to make the open meeting provision applicable to all board committees when it makes its compliance filing.

123. Bonneville challenges the provision allowing the board or the member representatives committee to take action without a meeting and asks that such actions be limited to those that are ministerial, urgent, or require confidentiality. Meetings in general are "open" to public observation of the proceeding; however, there is no guarantee that the public will have an opportunity to speak at such open meetings. If the board or member representatives committee believes that action does not necessitate direct interaction between board members or committee members, the public is not disadvantaged by not being present as there is no interaction to observe. For this reason, we will not require modification of these provisions of the Bylaws but require public disclosure of the action taken unless it requires confidentiality.

124. We agree with Bonneville that the Rules of Procedure should be more specific regarding when information regarding upcoming meetings will be given to members, and therefore require that NERC modify articles five and eight to provide that the material will be sent to members within 24 hours of the time it is provided to board members or members of the member representatives committee when it submits its compliance filing. Such a time limit is necessary, given that meetings may be held with only five- (for board meetings) to seven- (for member representatives committee meetings) days' notice.

125. Finally, we agree with Bonneville that there are potentially conflicting terms regarding notice prior to meetings. NERC has explained that the provision in article five is intended to mean without notice to the trustees. NERC is directed to amend the provision to reflect its intent so that there will be no confusion or potential conflict with respect to information and notice to be given to the public and members prior to such board meetings. NERC's reply did not address a similar issue raised with respect to meetings of the member representatives committee; therefore, we direct NERC to amend section 8 of article VIII to eliminate the provision permitting regular meetings without notice, or reconcile that provision with section 10, which requires notice of all member representatives committee meetings. These changes must be made in NERC's compliance filing.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

6. Expertise

126. It is critical that the ERO and each Regional Entity have adequate technical, financial, and other expertise in the selection of board members, the recruitment of staff, and the staffing of committees and subordinate organizational structures.[56] An ERO candidate must demonstrate in its application that it has the ability to develop and enforce Reliability Standards for the Bulk-Power System. The ERO 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.

NERC Proposal

127. NERC states that it has been successful in attracting highly-qualified candidates to its board, pointing to its current board members and their credentials, noting that the current NERC Council board will be the initial board of NERC Corp. when the two entities merge. NERC Council's current board members include individuals with advanced degrees in law, business, economics, agricultural economics, and civil, electrical, and electric power engineering. They have experience in government, academia, and private industry.

128. NERC Council currently has a staff of over 50 management, professional, and technical employees. NERC Council's newly elected president and chief executive officer has over 25 years of experience in electric industry management, system planning and forecasting, and regulation. NERC gives the backgrounds of the individuals responsible for several of its programs.[57]

129. The NERC Bylaws specify that the nominating committee endeavors to nominate candidates to the board with the objective that the board as a whole has experience in technical electric operations and reliability, legal, market, financial, and regulatory matters, and familiarity with regional system operation issues and reflects geographic diversity.[58] NERC Corp. intends to continue to use executive search firms and solicit nominations from industry stakeholders to identify highly-qualified candidates.

130. NERC notes that it has always relied on the technical expertise of electric industry volunteers. Nearly 1,000 people participate in NERC committees and subgroups, with others providing volunteer technical support at the regional level. Over 350 industry volunteers have participated in on-site audits since NERC instituted its reliability

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[56] Order No. 672 at P 175.

[57] Transmittal Letter at 5-21.

[58] Bylaws art. III, § 5.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

readiness review and improvement program in February 2004. NERC expects to continue this level of participation if it is approved as the ERO, relying on the strong support it has built within the industry sectors, with its experienced staff overseeing and facilitating the work of the volunteer technical experts. NERC also points out that it has worked regularly with representatives of major stakeholder groups, which enables it to obtain technical expertise when needed.

131. Experts also play a role in many phases of NERC's proposed Reliability Standard development process.[59] Under NERC's proposed development procedures, the standards committee will appoint a Reliability Standards drafting team with the necessary technical expertise, competencies, and diversity of views to draft Reliability Standards based on sound engineering and technical criteria using actual data and lessons learned from operating incidents. According to the development procedures, interested parties may complete a standard drafting team nomination form. The standards process manager then recommends candidates to the standards committee who may accept the recommendations of the standards process manager or select other individuals for the standard drafting team.

132. The NERC Rules of Procedure regarding Regional Entity compliance envision the use of industry experts, Regional Entity members,[60] and independent technical experts in various aspects of its compliance program.[61] NERC's Rules anticipate the use of industry experts, as appropriate, in investigations, audits, and other compliance activities relating to its monitoring of Regional Entity compliance.[62]

Comments

133. Numerous commenters cite to NERC's expertise, noting that its prior experience makes it uniquely qualified to be certified as the ERO. For example, NRECA states that

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[59] The Draft Reliability Standards Development Procedure, Version 5.0 (found at Application, app. 1) has not yet been approved by stakeholders and the NERC board. NERC proposes to file the approved procedure after its August 2, 2006 board meeting.

[60] "Regional entity compliance enforcement program staff shall have the authority and responsibility to investigate, audit (with the input of industry experts or regional members) . . . ." Rules of Procedure § 403.6.2.

[61] "Regional entity compliance enforcement program staff may call upon independent technical experts . . . to provide technical advice or recommendation in the determination of compliance or noncompliance in audits, investigations, or review of self-reported violations." *Id.* § 403.6.3.

[62] *Id.* § 404.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC's "experience, vision, expertise, well-established working relationships with industry stakeholders, business infrastructure, independence and scope" make it "uniquely qualified" to be the ERO.[63] Ameren states that "a hallmark of NERC's 40-year history is the participation of industry representatives and technical experts in setting voluntary Reliability Standards, coordinating planning and operations activities, and developing tools, systems and processes critical to maintaining the reliability of the Bulk-Power System."[64] It states that continued participation of such individuals is essential to the success of the ERO. Exelon also attests that "NERC has the 'high level of technical expertise needed' to develop and enforce Reliability Standards," citing to NERC's "highly qualified" independent board and senior management team, as well as its track record getting participation from technically-qualified industry volunteers.[65]

134. Alcoa asserts that the role of industry representatives in the ERO may undermine its independence. For example, it states that using industry volunteers in the audit process goes against the neutral nature of the audits.

135. Ameren notes that the application is silent on how industry expertise will be incorporated into the ongoing activities of the ERO other than Reliability Standard development. Ameren requests that the Commission clearly indicate to NERC the expectation that input from industry experts must continue in all ERO activities.

Commission Conclusion

136. The candidate ERO 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.[66] The 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. As described above, NERC's application documents NERC's past expertise and how it plans to maintain that expertise in the ERO framework. Most of the comments received extolled NERC's experience in gathering the expertise necessary to fulfill the duties of the ERO, including development and enforcement of Reliability

[63] NRECA at 3.

[64] Ameren at 6.

[65] Exelon at 3.

[66] Order No. 672 at P 175.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Standards. Accordingly, the Commission finds that NERC has adequately demonstrated its ability to attract and retain resources in the development and enforcement of Reliability Standards.

137. Alcoa asserts that industry representatives' roles in areas such as audits may undermine NERC's independence and the neutral nature of the audits. On the other hand, Ameren asks the Commission to clarify an expectation that industry expertise and input will continue beyond the context of Reliability Standard development. The specific issue of industry input into audits is addressed in the discussion of audits below.

7. NERC's Reorganization

138. As noted above, NERC states that, pursuant to its transition plan, NERC will continue operating under its present corporate structure while it works to put the ERO structure into place in its affiliate, NERC Corp. Once NERC Corp. is named as the ERO, the existing NERC will be merged into the new corporation and NERC Corp. will be the sole surviving entity.

Comments

139. National Grid states that NERC should disclose more information about the terms and conditions of the proposed merger between NERC Council and NERC Corp. and give the public an opportunity to comment on the terms and conditions, which NERC believes could affect aspects of NERC's future operations.

Commission Conclusion

140. National Grid has not pointed to any specific information required by Order No. 672 that NERC has failed to provide. NERC has provided sufficient information regarding the structure of the organization that will be the ERO to enable the Commission to evaluate its application.

8. Regional Advisory Bodies

141. A Regional Advisory Body is an entity established upon petition to the Commission pursuant to section 215(j) of the FPA and section 39.13 of the Commission's regulations. It 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.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

142. NARUC and the California Commission state that NERC's failure to recognize the role of Regional Advisory Bodies renders NERC's application "facially deficient." The California Commission alleges that NERC failed to accommodate comments California Commission filed on NERC's earlier draft applications by failing to recognize the Regional Advisory Body's role in reviewing standards, budgets, enforcement, and reliability and adequacy assessments. NARUC and California Commission state that the Commission should require that the application be amended to provide for the role and funding of Regional Advisory Bodies.

143. NARUC and California Commission also ask the Commission to clarify that Regional Advisory Bodies have an important role in assisting the Commission to balance reliability and competitive concerns.

Commission Conclusion

144. We note commenters' concerns regarding NERC's failure to address the role and funding of the Regional Advisory Bodies. However, Order No. 672 did not specifically require the applicant to address either issue as part of its application. In addition, we note that it was not until Order No. 672-A that the Commission made it clear that the Regional Advisory Bodies may be funded through the ERO. However, Order No. 672 stated that the Commission would consider different approaches to Regional Advisory Body funding on a case-by-case basis.[67] It is understandable that NERC's application would not address such funding, given the short time period between issuance of Order No. 672-A and the filing of the application and the case-by-case approach taken in that order. However, as NERC makes its future filing addressing other funding issues raised in this order, it must include details regarding funding of Regional Advisory Bodies. We note that we are concurrently issuing an order in Docket No. RR06-2-000, approving the first petition to establish a Regional Advisory Body, which will provide guidance on how Regional Advisory Body budgets may be submitted.[68]

145. While it may have been beneficial for NERC to recognize the role and input of a Regional Advisory Body, it was not required to do so under Order No. 672. The FPA and our corresponding regulations give an established Regional Advisory Body the right to offer advice to the ERO regarding certain issues; that right exists regardless of whether the ERO explicitly recognizes it. Moreover, NERC's proposed Rules and processes provide many opportunities for stakeholder input, which would certainly include input

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[67] Order No. 672-A at P 68.

[68] *Governors of Arizona, California, Colorado, Montana, Nevada, New Mexico, Oregon, Utah, Washington, and Wyoming*, 116 FERC ¶ 61,061 (2006).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

from the Regional Advisory Bodies. We will not require that NERC's application specifically address Regional Advisory Body input; however, NERC is free to include such details in a subsequent filing if it wishes to do so. Although we are not requiring such a change at this time, we believe that, as NERC gains experience with Regional Advisory Bodies, it may be appropriate to reflect their role formally in its governing documents.

B. Recognition in Canada and Mexico

146. Section 39.3(b)(2)(v) of the Commission's regulations provide that the ERO, upon certification, take appropriate steps to gain recognition in Canada and Mexico.

NERC Proposal

147. In its application, NERC states that its goal is to coordinate standards development, compliance and enforcement, reliability assessments, and other ERO functions on an international basis; and ensure consistent policy and actions affecting the ERO. As part of its efforts to be recognized as the ERO in each applicable Canadian jurisdiction, NERC is also pursuing recognition and ERO authority equivalent to that granted in EPAct. Further, NERC intends to file its application of Recognition or Notice of Filing of an Electric Reliability Organization with eight of the ten provinces concurrently with its filing in the United States and will request equivalent recognition in the provinces on the same date as the ERO certification date.

148. NERC states that because Mexico does not currently have a regulatory authority with jurisdiction over reliability, it is not seeking recognition from Mexico at this time.

149. NERC has included placeholders throughout the Bylaws stating that when the Corporation receives recognition as the ERO from the appropriate regulatory authorities in Mexico, the provision will be expanded to provide adequate representation of Mexican interests.

Comments

150. WECC states that it will have separate contractual relationships with the Canadian provincial entities and the Mexican regulator to which NERC will not be a party. WECC urges the Commission to acknowledge these international contracts and to provide flexibility in the delegation process for Cross-Border Regional Entities to reflect these international relationships.

Commission Conclusion

151. We find that NERC is properly complying with the requirements of section 39.3 (b)(2)(v) of our regulations. We encourage NERC and the Regional Entities to continue

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

to seek recognition in Canada and Mexico, as appropriate.[69] NERC and the Regional Entities should keep the Commission informed about the status of efforts to gain recognition in Canada or Mexico. We expect to be flexible, as necessary and appropriate within the requirements of section 215 of the FPA, when reviewing the delegation agreements as they pertain to Cross-Border Regional Entities.

152. WECC has not submitted sufficient information for the Commission to make a determination regarding its proposed international contracts, nor do we believe that such issue needs to be addressed in this proceeding. Order No. 672 stated that 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.[70] NERC and WECC should address this issue in any proposed Western delegation agreement filed by the ERO.

C. Funding

153. Section 39.3(b)(2)(ii) of the Commission's regulations provides that the Commission may certify an ERO if it has established Rules that allocate equitably reasonable fees and charges among end users for all activities under the regulations established in Order No. 672.

154. Section 39.4(a) of the Commission's regulations provides that an ERO candidate shall include in its certification application a formula or method for the allocation and assessment of ERO dues, fees and charges. The ERO shall fund the Regional Entities for delegated activities under section 215 of the FPA.

1. Billing and Collections

NERC Proposal

155. NERC's application proposes to base allocation of all costs for statutory activities on net energy for load. Costs incurred to implement the statutory functions for one Interconnection, region or entity will be directly assigned to that Interconnection, region or entity and allocated within it based on net energy for load.[71] NERC will require each Regional Entity to identify all load serving entities within the footprint of the Regional Entity and the net energy for load of each load serving entity. The net energy for load reported by balancing authorities within a region will be used to rationalize and validate

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[69] Order No. 672 at P 182.

[70] *Id.* at P 712.

[71] Rules of Procedure § 1102.1 – 1106.3; Transmittal Letter at 74 & n.25.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

cost allocation for collection through a Regional Entity processes. Where appropriate, a Regional Entity will allocate funding obligations using a NERC-approved alternative method.

156. NERC proposes to have the Regional Entities perform the billing and collection from the load serving entities within their geographic boundaries. The billing and collection process will provide: (1) a clear validation of billing and application of payments; (2) a minimum of data requests to those being billed; (3) adequate controls to assure integrity in the billing determinants, including identification of entities subject to NERC's authority; and (4) consistent billing and collection terms. Absent an agreement to have a Regional Entity perform the billing and collection function, NERC proposes to perform such functions in that region. Alternatively, a load-serving entity may pay its ERO charges through a Regional Entity-managed collection mechanism.

Comments

157. Some commenters challenge the use of net energy for load for cost allocation. Alcoa argues that NERC's proposal to bill on the basis of net energy for load will not result in an equitable allocation of ERO costs because customers with high load factors will pay a disproportionately high cost. Instead the costs should be allocated on the basis of load serving entities' shares of demand and energy. It contends that the Commission's electric ratemaking methodology has recognized that basing the charges on demand as well as energy takes into account the variations due to load factors.[72] If the Commission adopts net energy for load, it should at least exclude behind the meter generation because customers with behind the meter generation do not benefit from the reliability of the Bulk-Power System and should not have to pay for the ERO.

158. Entergy is concerned that NERC's proposal to bill load serving entities on the basis of net energy for load will mean a free-ride for qualifying facilities and independent power producers because they are not considered load serving entities although they place burdens on the Bulk-Power System. Qualifying facilities and independent power producers should also pay their fair share for ensuring the reliability of the Bulk-Power System. California Cogeneration interprets NERC's definition of load serving entity in its funding proposal to mean that qualifying facilities would be exempt from funding the ERO and Regional Entities. ConEd states that all entities, including generators that benefit from the services of the ERO, should pay their fair share of the costs of the ERO.

159. In its reply comments, SoCal Edison disagrees that qualifying facilities which sell output to utility companies under the Public Utility Regulatory Policies Act of 1978 should not be considered a "user" of the Bulk-Power System. As such, they should not have to comply with mandatory Reliability Standards because EPAct 2005 does not

[72] Alcoa at 27.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

provide such an exemption. Further, SoCal Edison states that this assertion has not been fully supported and that if the Commission were to exempt qualifying facilities from mandatory Reliability Standards, other equally significant power generators may request an exemption.

160. Santee Cooper states that the Commission should clarify that there will be no subsidization among Regional Entities and asks the Commission to take appropriate steps to ensure that the costs incurred by a Regional Entity to perform its delegated functions will be directly assigned to, and paid by only those load serving entities located within the geographic boundaries of that Regional Entity. MEAG seeks Commission clarification that there is no subsidization between regions. This preclusion of cross subsidization between regions should apply to all of a Regional Entity's costs – not just those undertaken pursuant to statutory responsibilities under FPA section 215.

161. Some commenters recommend balancing authorities serve as the billing agents for NERC rather than the Regional Entities. ELCON does not object to Regional Entities acting as collection agents, but contends that NERC and the Commission must provide the necessary guidance and controls to ensure that no double-billing occurs for any funding entity, such as the load serving entities.

162. Santee Cooper asserts that NERC should not rely on Regional Entities to serve as its collection agents for funding purposes, emphasizing that a Regional Entity has no greater capability than does NERC in bill collection. It is concerned that NERC as ERO might apply undue pressure on any regional reliability council seeking to enter into a regional delegation agreement with NERC to "voluntarily" agree to serve as NERC's collection agent. Santee Cooper requests that the Commission clarify that NERC should serve as the collection agent and that it may not impose this responsibility on the Regional Entities.

163. APPA supports collection of dues from end users on the basis of net energy for load, but recommends that the 135 balancing authorities should be used as billing intermediaries rather than thousands of load serving entities. It contends that net energy for load is not calculated at a load serving entity delivery voltage level, which means that the ERO and the Regional Entities will be forced to impute, request or calculate load serving entity specific loss factors to convert the amount of annual net energy for load to the metered energy delivered to each load serving entity. Therefore, it makes more sense to bill the 135 balancing authorities, rather than thousands of small load serving entities, most of which are not direct users of Bulk-Power System and will never have a direct business relationship with the ERO. Balancing authorities can recover the costs of their ERO dues from retail end users and wholesale customers by including these costs in their transmission or ancillary service rates. WECC also favors a Regional Entity having the option to bill a balancing authority because it is required to do so in some jurisdictions.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

164. FRCC asserts that any Regional Entity that performs the collection function on the ERO's behalf should not be responsible for any non-payments and suggests adding language to that effect to the *pro forma* delegation agreement.

NERC Reply Comments

165. NERC states that it agrees with commenters that any potential for cross subsidization among regions should be minimized and that this is the reason for section 1102.4 of the Rules of Procedure, which requires that costs incurred for one Interconnection, Regional Entity or group of entities must be directly assigned to that Interconnection, Regional Entity or group of entities.

Commission Conclusion

166. The Commission finds that NERC's proposal meets the threshold requirements of section 39.3(b)(2)(ii), that an ERO candidate have established Rules that allocate equitably reasonable fees and charges among end users, and section 39.4(a), that an ERO candidate include in its certification application a formula or method for the allocation and assessment of ERO dues, fees and charges.

167. We accept NERC's proposal to allocate costs on the basis of net energy for load. We deny requests that the Commission should require NERC to allocate costs on a basis other than net energy for load. In Order No. 672, we found that funding apportionment method based on net energy for load is a fair and reasonable method for allocating costs that minimizes the possibility of "double-counting."[73] We will not revisit this determination. Moreover, any request to require NERC to allocate costs on a basis other than net energy for load is an impermissible collateral attack on Order No. 672.

168. While APPA's proposal to require NERC to bill balancing authorities may have some merit, we do not require NERC to do so. NERC intends to bill load-serving entities and have the Regional Entities serve as intermediary collection agents, but will allow a Regional Entity to allocate its funding obligation using an alternative method, including billing balancing authorities. We find that this flexibility allows NERC to accommodate the specific needs of a Regional Entity. Any proposed alternative billing formula must be submitted to the Commission for approval in either a delegation agreement or other documents.

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[73] Order No. 672 at P 213 & n.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.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

169. We also accept NERC's general approach that Regional Entities will either perform billing and collection for the ERO or will manage the billing and collection. However, we direct NERC to adopt appropriate safeguards in the delegation agreement to ensure that (1) the Regional Entities transfer the money to the ERO in a timely manner and (2) the Regional Entities do not use their position as billing agent and collector to unduly influence ERO's decisions. We clarify that this money belongs to the ERO and the Regional Entity is simply serving as a collection agent.

170. Several commenters seek an exemption from the funding obligation based on their status as a qualifying facility, independent power producer, or owner of behind the meter generation. Others insist that qualifying facilities should not have a "free ride." We will not grant a general blanket waiver to any entity from the funding obligation because section 215 requires ultimate funding to be allocated among end users, and does not exclude specific types of load, including load served by behind the meter generation, or suggest that allocation of cost responsibility among end users will depend on how they use, or what benefits they receive from, the Bulk-Power System.

171. With regard to Santee Cooper's and MEAG's concerns regarding cross-subsidization, we agree that the costs incurred by a Regional Entity to perform its delegated functions should be paid by the entities within that region and not cross-subsidized by entities within other regions. As we stated in Order No. 672, "any funding proposal must ensure that cross-subsidization is minimized."[74] Neither Santee Cooper nor MEAG identify any provision of NERC's application that is inconsistent with this principle and, thus, we will not require any specific revision by NERC.

172. We agree with FRCC that a Regional Entity that performs the collection for ERO should not be responsible for non-payment in the event that a user, owner or operator of the Bulk-Power System does not pay its share of dues, fees and charges in a timely manner. However, any revenues not paid should be recovered from others within the same region to avoid cross-subsidization between regions. We direct NERC to adopt language to that effect either in the delegation agreement or Rules of Procedure as a part of its compliance filing.

2. Funding of Activities

173. Order No. 672 provides that federal authorization of funding is limited to the ERO's pursuit of statutory functions. However, the ERO or a Regional Entity is not precluded from pursuing other activities, funded from sources other than the

[74] *Id*. at P 214.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission-approved ERO funding mechanism.[75] The ERO and each Regional Entity must ensure that the respective delegation agreement lists all the statutory activities that they intend the Regional Entity to undertake on behalf of the ERO.[76]

NERC Proposal

174. In Exhibit E of its proposed *pro forma* delegation agreement, NERC describes the scope of activities to be funded through the ERO funding mechanism. Each Regional Entity must identify costs that will be incurred in support of delegated activities and activities that are in furtherance of NERC's responsibilities as the ERO under section 215, as specified in the NERC Rules. These activities include: (1) Reliability Standard development; (2) enforcement; (3) organization registration and certification; (4) reliability readiness review and improvement; (5) reliability assessment and performance analysis; (6) training and education; and (7) situational awareness and infrastructure security.

175. NERC also intends that it and the Regional Entities may also bill members or others for non-statutory activities. Costs and revenues associated with non-statutory functions and services will be separately identified and not commingled with billings associated with Commission-approved funding of the ERO or of the Regional Entities for delegated activities.

Comments

176. A number of commenters refer to the ambiguity in NERC's application as to whether activities are statutory or non-statutory under section 215 of the FPA, and whether they will be funded by the ERO. FRCC asks that NERC clearly list non-statutory activities it intends to pursue along with funding sources for those activities. In addition, it should adopt a Rule to ensure that funding for statutory activities will not subsidize any non-statutory functions. ISO/RTO Council argues that the Commission should reserve judgment on many of the activities NERC wants to perform in the name of reliability, which it labels as statutory activities, until NERC makes a clear showing in its detailed budget and business plan that the ERO is the right entity to perform those activities. Santee Cooper seeks assurance that the principle that "[c]osts incurred to accomplish the statutory functions for one Interconnection, regional entity, or group of entities will be directly assigned to that Interconnection, regional entity, or group of entities …" would apply to non-statutory activities, such as economic planning.

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[75] *Id*. at P 202.

[76] *Id*. at P 230.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

177. ConEd and others ask the Commission to clarify that NERC's review of non-statutory activities is for informational purposes only and that the ERO lacks approval authority for the funding of non-delegated activities. NARUC asserts NERC's application incorrectly implies that NERC can exercise some level of oversight regarding non-statutory functions and argues that such oversight could interfere with the independence of Regional Entities and goes beyond the scope of the ERO's delegated functions.

178. According to FRCC, although statutory activities are limited to developing and enforcing Reliability Standards, NERC's *pro forma* delegation agreement lists several non-statutory functions as if they are permissible statutory activities. For example, organizational certification, reliability readiness review and improvement, training and education, and situational awareness are not related to either the development or enforcement of Reliability Standards and therefore, should be considered non-statutory activities. FRCC does not oppose the ERO's pursuit of these activities; it simply wants the ERO to develop alternative mechanisms to fund these non-statutory activities. Alcoa also contends that such activities are non-statutory and should be funded through some other means.

179. FRCC is concerned that some tools, such as Interchange Distribution Calculator, are not used by each region equally and therefore funding the cost of such tools on the basis of net energy for load is unreasonable. According to FRCC, the cost related to the development of Interchange Distribution Calculator should not be considered a statutory activity.

180. ISO/RTO Council argues that NERC should not undertake some proposed activities because its involvement with them presents a conflict of interest. For example, NERC proposes to develop specific software tools to implement NERC tagging requirements as well as an Interchange Distribution Calculator tool. If NERC is allowed to provide these tools, the entity that is responsible for setting and enforcing Reliability Standards could very well become the sole provider of unregulated tools to comply with those Reliability Standards, presenting a conflict of interest.

181. ISO/RTO Council takes issue with NERC's involvement with "reliability readiness review and improvement" and recommends that the Commission allow the formation of a separate Institute of Nuclear Power Operations (INPO)-type organization to perform reliability-related non-statutory functions. ISO/RTO Council also points out that the ERO's Rules of Procedure, section 1001, may be interpreted to allow NERC to exercise real-time operating authority. Because the ERO has the power to impose penalties, system operators may feel pressure to implement the wishes of NERC.

182. National Grid asks the Commission to condition its certification of NERC as the ERO based on satisfactory resolution of whether the Regional Entities will have tariffs

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

under which specific charges and cost allocation mechanisms will be specified. ELCON states that many Transmission Providers already recover their costs of funding NERC and regional reliability councils by including such costs in their Open Access Transmission Tariff (OATT), other transmission service agreements, or power supply agreements. Any funding proposal should take this into consideration and any new billing from the ERO should eliminate costs if such costs are included in the OATT. In this regard, NRECA asks the Commission to add the following language as new item 4.5 under section 1106:

> Guidance and controls to avoid double billing of any funding entity, *i.e.*, load serving entities, for ERO funding purposes, taking into account the reality that in many instances current and past NERC funding costs have been and are currently reflected in the Open Access Transmission Tariff (OATT) rates of transmission providers as well as other transmission and power supply arrangements.

NERC Reply Comments

183. NERC states that it believes all the activities it proposes to perform as the ERO are either explicitly required by the statute or are necessary and appropriate corollaries to carrying out the ERO's express statutory responsibilities. It intends to provide detailed descriptions of each of these activities, along with associated costs, in its budget submission to the Commission. That filing will provide the appropriate forum to address the issues raised by commenters concerning the budget and funding of various activities.

Commission Conclusion

184. Order No. 672 requires the ERO and each Regional Entity to ensure that the respective delegation agreement lists all the statutory activities that they intend the Regional Entity to undertake on behalf of the ERO.[77] Exhibit E of NERC's proposed *pro forma* delegation agreement identifies certain activities to be funded through the ERO funding mechanism and the Rules of Procedure provide additional detail on these activities. NERC indicates that all of the activities it proposes to perform as the ERO are required by the statute or are necessary to carry out those statutory responsibilities. NERC commits to provide more description of its activities in its proposed budget filing. This should provide sufficient detail for the Commission or other stakeholders to determine the complete scope of statutory activities. NERC is directed to identify a specific accounting process for the funding of statutory and, as necessary, non-statutory activities, including the costs of billing such activities, to ensure that funding derived from section 215 will exclusively support statutory activities.

185. FRCC, ISO/RTO Council and Alcoa believe that a number of ERO activities

[77] Order No. 672 at P 230.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

identified in NERC's application to be performed by NERC as the ERO such as organizational certification, reliability readiness review and improvement and training and education are non-statutory, arguing that they have nothing to do with developing or enforcing Reliability Standards. We will reserve judgment until NERC files its detailed budget. Based on our instruction to NERC of what to provide and NERC's plan to provide detailed descriptions of each of the activities along with associated costs in its budget and funding proposal, that filing will be the appropriate forum to address issues raised by commenters. We generally believe that anything required of the ERO or a Regional Entity by the statute, Order No. 672 pursuant to the statute, or any subsequent Commission order pursuant to section 215 of the FPA is a statutory activity.

186. In addition, we disagree with the ISO/RTO Council's assertion that section 1001 gives NERC the ability to exercise real-time operating authority. Section 1001 limits NERC's role to leadership coordination, technical expertise and assistance to the industry in responding to events. None of these activities entails real-time operational control over the Bulk-Power System.

187. While we agree with ConEd and NARUC that NERC does not have authority to approve the non-statutory portion of Regional Entity budgets, Order No. 672 does provide for ERO review of those portions of a Regional Entity's budget to ensure that non-statutory duties do not impose a conflict of interest or otherwise unduly hinder the accomplishment of statutory duties.[78]

188. We believe that ISO/RTO Council's concern that some of NERC's activities, services or tools may present a conflict of interest is unfounded. NERC, as a not-for-profit entity, has no financial incentive to promote these tools and services. Moreover, these services are extremely useful for the provision of adequate reliability, because they relate specifically to compliance with existing standards and they proactively help avert Reliability Standard violations and system disturbances. At this time, in the absence of an independent organization stepping forward to provide some of these services as with the example of INPO in the nuclear industry, adequate reliability on the Bulk-Power System is better assured if the ERO offers to provide them.

189. Finally, in response to National Grid, we decline to adopt a particular tariff mechanism for the entities that fund NERC and Regional Entities to recover their costs because we do not yet have a detailed funding proposal before us and it is not clear that such a tariff mechanism is appropriate.

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[78] *See* 18 C.F.R. § 39.4(b) and 39.4(g) (2005).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

3. Budget Development

190. Section 39.4(g) of the Commission's regulations provides that the ERO 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.

191. Section 39.4(b) of the Commission's regulations provides that the ERO 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 the regulations established pursuant to Order No. 672. Order No. 672 contemplates that an ERO candidate would propose budget principles in its certification application.[79]

NERC Proposal

192. NERC proposes a fiscal year to begin each January 1. The NERC annual budget process will be initiated in March to allow sufficient time for NERC to receive member inputs and to allow for regulatory approval for the following fiscal year.[80] NERC proposes to file for approval by the applicable regulatory authorities at least 130 days in advance of the start of each fiscal year (i.e., by August). The filing shall include: (1) the complete NERC and Regional Entity budgets, including the business plans and organization charts approved by the board; (2) NERC's annual funding requirement (including Regional Entity costs for delegated functions); and (3) the mechanism for assessing charges to recover the annual funding requirement, together with supporting materials for the requested funding.

193. Each Regional Entity must submit its annual budget for carrying out its delegated functions as well as all other activities and funding to NERC no later than June 1 of the prior year, together with supporting materials. These materials should include a complete business plan and organization chart explaining the 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. NERC proposes to review and approve each Regional Entity's budget for adequacy in meeting the requirements of its delegated authority. The proposed *pro forma* delegation agreement states that NERC will presume that a Regional Entity's budget is reasonable if the Regional Entity's governing body has approved it for submission to NERC but will not presume that it is adequate for

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[79] Order No. 672 at P 197.

[80] Rules of Procedure § 1103.1.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the Regional Entity to perform its delegated functions. NERC reserves the right to review, from time to time, in reasonable intervals but no less than every three years, the financial books and records of each Regional Entity with delegated authority in order to ensure that the documentation fairly represents in all material respects appropriate funding of delegated functions.[81]

194. NERC's proposed *pro forma* delegation agreement also requires each Regional Entity to submit annually a list of all load serving entities within its geographical boundaries. NERC will then seek approval from the applicable governmental authorities for all load-serving entities to be compelled to pay all NERC and Regional Entity costs under their jurisdiction.

Comments

195. According to National Grid, NERC's funding proposal at a very high level seems appropriate, but raises many questions and the Commission should condition its approval of NERC to become ERO on satisfactory resolution of those questions.[82] For example, in NERC's detailed budget proposal, it should explain how Regional Entities will fairly allocate costs within their respective footprints.

196. Alcoa and ELCON assert that there should be no presumption of reasonableness regarding a Regional Entity's budget, particularly one that is based solely on the approval of such budget by the governing body. Alcoa recommends that Regional Entities must be made accountable for spending overruns through the delegation agreement. Alcoa opposes section 8(g) of the *pro forma* delegation agreement which provides that "NERC will presume Regional Entity's budget is reasonable if Regional Entity's governing body has approved the budget for submission to NERC."

197. Several commenters raise issues regarding the presumption that a Regional Entity budget is reasonable if approved by the Regional Entity's governing body. NRECA questions the distinction between the reasonableness and adequacy of the budget of the Regional Entities and expresses concern about the possibility that a Regional Entity might take the position that an increased expenditure or associated level of activity would cause the resulting actions or activities to be deemed unreasonable. It requests greater specificity in how NERC will evaluate the budgets of the Regional Entities.

198. Similarly, APPA recommends that the Commission should state that it intends to review closely the reasonableness of Regional Entity budgets to accomplish statutory activities, since NERC intends only to review such budgets for adequacy. APPA believes

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[81] *Id*. § 1104.3.

[82] National Grid at 18-22.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

that NERC's approach fails to apply NERC's expertise or adopt a grid-wide perspective to contain regional costs in support of consumer interests in lower electric rates. APPA and ELCON are concerned that the ERO and Regional Entities will grow in ways allegedly similar to RTOs, becoming large and unresponsive with no financial accountability for the costs they impose on end users.

199. On the other hand, the California Commission asserts that the *pro forma* delegation agreement should provide for deference to the budget submission of an Interconnection-wide Regional Entity by stating that the regional budget and its collection mechanism shall be rebuttably presumed to be adequate and appropriate. This includes providing for the performance and funding of reliability functions that are not delegated functions but which are found by the regional organization to be essential for maintaining overall reliability in a region.

200. ELCON is concerned that if the ERO adopts a "cost-plus" management style and the Commission is not careful, the industry will be burdened by high costs of maintaining the reliability of the Bulk-Power System akin to high costs experienced by the ISOs and RTOs. FirstEnergy asks the Commission to carefully monitor the budgets submitted and approved by the ERO to ensure that proper fiscal controls are in place to prevent excessive costs from being imposed on users of the Bulk-Power System.

201. Alcoa asks that the Commission require the ERO and Regional Entities to identify and publish a list of all entities that fund the ERO and Regional Entities' operations. SoCal Edison recommends that NERC establish a separate funding registry, which will list load serving entities that will be responsible for paying dues, fees and charges. The list of load serving entities in the compliance registry will be a subset of load serving entities on the funding registry. The funding registry should be updated on a periodic basis and posted on the website.

Commission Conclusion

202. We agree with National Grid that NERC's funding proposal at a very high level seems appropriate, but lacks details. Consistent with Order No. 672, we direct NERC to submit in its compliance filing a list of budget principles for approval. These principles should include budget execution as well as budget formulation matters, including: (1) budget component justification based on statutory or other authorities; (2) how the budgeted activity lends itself to the accomplishment of the statutory or other authorities; (3) methods of calculating budget estimates; (4) who prioritizes competing needs; (5) affordability, sustainability, and efficiency and effectiveness of expenditures; (6) implementation to meet international standards; (7) transparency; and (8) accountability and execution in accordance with operating plan, performance measures, and shifting

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

priorities. Moreover, we expect NERC to submit its first detailed budget in the coming months that should answer many of these questions.[83] Parties will have an opportunity to comment on the budget.

203. NERC has not provided sufficient rationale for the provision that would establish a presumption of reasonableness by the ERO of a Regional Entity's budget if the Regional Entity's governing body has approved its budget. We believe that this proposed provision could hinder the ERO's ability to conduct a meaningful review of the proposed Regional Entity budgets as contemplated by Order No. 672 and is inconsistent with the overarching goal of establishing a strong ERO. Accordingly, we direct NERC to remove this provision from the *pro forma* delegation agreement. For similar reasons, we reject the California Commission's suggestion that the ERO apply a presumption of adequacy and appropriateness to an Interconnection-wide Regional Entity's budget proposal. Although we believe that Regional Entities will generally be in the best position to determine their budgetary needs, we do not believe that a formal "rebuttable presumption" is necessary or appropriate or otherwise consistent with Order No. 672. We agree with the California Commission that the budget should provide for performance and funding of reliability functions that are essential for maintaining overall reliability, that the way to accomplish this is by having the ERO review the budget and, where necessary, suggest or make changes and not presume the budget and thus the activities to be reasonable.

204. With regard to the concerns of FirstEnergy and ELCON regarding the potential for excessive or duplicative costs being imposed on users, participants in the ERO processes will have an opportunity to address these issues as they arise. Further, the Commission will review and accept the ERO and Regional Entity budget proposal to ensure that excessive or duplicative costs are not passed on to end users.

205. The Commission will not require NERC to adopt the recommendation of Alcoa and SoCal Edison that the ERO establish a funding registry listing entities that are responsible for paying dues, fees and charges. Rather, we will allow the ERO to consider whether such a registry has merit.

4. Funding Transition Plan

206. Section 39.4(f) of the Commission's regulations provides that an ERO candidate may propose a plan for a transitional funding mechanism that would allow the ERO, if it is certified as the ERO, to continue existing operations without interruption as it transitions from one method of funding to another.

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[83] The Commission recognizes, however, that the submission of NERC's budget principles in its compliance filing will occur after NERC files its first budget.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC Proposal

207. NERC does not propose a transitional funding mechanism, *per se*. Upon certification as the ERO, NERC will submit a budget and funding requirements filing to the Commission for approval. The proposal will seek recovery of all funding for statutory functions through a charge based on net energy for load collected from all load serving entities.

Comments

208. FRCC notes that NERC's Transition Plan, states that contingent upon it being certified as the ERO and approval of the 2007 ERO budget, NERC would no longer be funded by the regional reliability councils after December 31, 2006. FRCC submits that NERC's Transition Plan should allow for the possibility that the transition to the ERO budget and funding could be delayed and should specify contingency plans that would avoid any possible gap in NERC funding.

209. Northern Indiana asserts that the Transition Plan should consider any overlap for annual fees paid to the regional reliability councils before the transition to invoicing by NERC. For example, if a regional reliability council member has in 2006 paid the regional reliability council dues or fees for a period that extends into 2007, then NERC's invoices in the transition period must take that into account and not assess a charge for that period.

Commission Conclusion

210. Section 39.4(f) provides for, but does not require, the ERO candidate to file a transitional funding mechanism. NERC did not include a transitional funding mechanism, but it may do so if its implementation plan is delayed for any reason.

211. We also agree with Northern Indiana that if an entity has already paid a portion of its dues in 2006 for 2007, NERC should take that into account when it calculates dues for that entity for 2007.

5. Other Funding Matters

212. ConEd suggests that NERC should adopt creditworthiness standards for entities that will fund the ERO to minimize instances of non-payment and to improve the ERO's financial stability.

213. While APPA and NRECA support NERC's setting a minimum threshold of $100 for billing the load serving entities, SoCal Edison and National Grid argue that NERC did not provide any justification for this waiver. National Grid states that section 1106.6 leaves open the possibility that NERC at some future date may raise the minimum

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

threshold for paying dues and fees and wants NERC to carry forward a balance from year to year for small load serving entities until the accumulated amount reaches a level to justify rendering a bill.

214. National Grid asks the Commission to condition its approval of NERC to become the ERO on satisfactory resolution of, among others things, who bears the risk of under-recovery of program costs.

215. NRECA and SoCal Edison state that the assignment of funding responsibility should not be the basis for imposing any Reliability Standard on that entity because a separate list – the compliance registry – identifies the users, owners and operators of the Bulk-Power System that are subject to the Reliability Standards.[84] They state that NERC's transmittal letter adequately captures this, where it states that the collection process will provide: "Adequate controls to ensure integrity in the billing determinants including identification of entities responsible for funding NERC's operations."[85] However, elsewhere in the application, there are two instances where the following language appears, which they assert is inconsistent with the above language: "Adequate controls to ensure integrity in the billing determinants including identification of entities subject to NERC's authority." NRECA and SoCal Edison assert that NERC should correct the two instances of incorrect language to reflect that entities responsible for funding are not necessarily subject to Reliability Standards.

NERC Reply Comments

216. NERC states that the waiver of an assessment of less than $100 is proposed to lessen the administrative burden and costs of the ERO, the Regional Entities, and the load-serving entities.

Commission Conclusion

217. The Commission will not require NERC to adopt creditworthiness standards at this time because ERO funding is required by statute of all end users. It is not clear that a creditworthiness standard would provide any further assurance of funding. However, NERC's compliance filing should address National Grid's concern regarding risk of under-recovery of program costs.

218. We accept NERC's proposal to not bill load serving entities that incur less than $100 of dues, fees and charges as a matter of administrative convenience rather than a

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[84] NRECA at 6; SoCalEd at 3. *See also* Transmittal Letter at 74.

[85] Transmittal Letter at 74.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

waiver. In addition the cost of billing and collection a *de minimus* amount may be higher than the revenue collected.

219. Furthermore, we agree with NRECA and SoCal Edison that the assignment of funding responsibility should not be the basis for applicability of Reliability Standards. Accordingly, we direct NERC to remove the inconsistency in its compliance filing.

D. Reliability Standard Development Process

1. General Issues

220. Section 39.3(b)(1) of the Commission's regulations provides that the ERO applicant must have the ability to develop and enforce Reliability Standards that provide for an adequate level of reliability of the Bulk-Power System. Any proposed Reliability Standard development process must ensure that any Reliability Standard is technically sound and that the technical specifications proposed would achieve a valuable reliability goal.[86] The process must be open and fair, appropriately balance the interests of stakeholders, include steps to evaluate the effect of a proposed Reliability Standard on competition, meet the requirements of due process, and not unnecessarily delay development of a proposed Reliability Standard.[87]

NERC Proposal

221. NERC states that its will develop Reliability Standards in accordance with section 300 (Reliability Standards Development) of its Rules of Procedure and the NERC Reliability Standards Development Procedures, which are incorporated into the Rules of Procedure as Appendix A. NERC states that, in March 2003, the ANSI Executive Standards Council accredited NERC's Reliability Standards Development Process.

Comments

222. MEAG states that once an initial set of Reliability Standards is accepted by the Commission, the Commission should direct NERC to give priority to compliance, not developing new standards. This will provide the users, owners and operators of the Bulk-Power System with both the opportunity and time to gain an understanding of what is expected of them under the new ERO regime. MEAG states that, until a future blackout occurs, any growth in the number or complexity of NERC's standards should be minimal.

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[86] Order No. 672 at P 258.

[87] *Id*.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

223. FRCC asks NERC to explain the relationship between section 300 of the proposed Rules of Procedure and Appendix 1 to the Rules of Procedure, which contains the Reliability Standard development process. FRCC comments that section 300 and Appendix 1 are not identical and that it does not see a need for section 300 in light of ANSI endorsement of the existing procedures which FRCC believes is reflected in Appendix 1. Alternatively, it asserts that the Commission should direct the ERO to resolve any differences between the two.

224. Georgia Operators and Allegheny assert that NERC's Rules of Procedure are not clear on whether NERC intends to obtain Commission approval prior to the enforcement of all Reliability Standards. They cite the provision that states that "Reliability Standards may, at the discretion of the board, be filed with applicable regulatory agencies in the United States, Canada and Mexico."[88] Georgia Operators and Allegheny request that the Commission specifically require that all Reliability Standards that NERC proposes to enforce must first be approved by the Commission. In addition, the Commission should require NERC to modify Appendix 1 to remove this ambiguity.

225. Similarly, SoCal Edison asserts that the board should not have the discretion on what Reliability Standards should be filed with the Commission and asks that step 10 of Appendix 1 be modified to read: "A Reliability Standard that is adopted by the board shall be submitted to ERO governmental authorities for approval and become effective on a date designated by the board …."[89]

226. Bonneville asks the Commission to require NERC to modify its Reliability Standard implementation plan to include both a timetable and a business plan for each Reliability Standard. It asserts that a reasonable effective date for each Reliability Standard and for imposing a sanction are critical because certain entities may be unable to comply with the Reliability Standards immediately upon approval because they may have to modify their transmission systems or operating practices. It asserts that the business plan should include: 1) a discussion of the incremental reliability improvements that will result from the standard; 2) a discussion of the impact of the standard on each type of entity within the industry, as listed in NERC's Reliability Functional Model; and 3) an analysis of the expected costs to implement the standard and the distribution of costs among the various functional entities.

227. Bonneville agrees with NERC that each Reliability Standard should be reviewed every five years, but goes further to request that the Commission require that a Reliability Standard expire unless it is re-approved.

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[88] Rules of Procedure, app. 1, step 11 on page 21.

[89] SoCal Edison at 7.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC Reply Comments

228. In its answer, NERC states that it understands that as the ERO it must file all Reliability Standards with, and obtain approval from, the Commission if the standard is to become mandatory and enforceable regardless whether it was developed through the NERC Reliability Standard development process or an approved Regional Entity Reliability Standard development process.

Commission Conclusion

229. The Commission will not direct NERC to give priority to compliance over developing new Reliability Standards as requested by MEAG. Bulk-Power System reliability depends on both enforcing the Commission-approved Reliability Standards and improving the Reliability Standards over time. We believe that NERC should not simply react to blackouts in developing Reliability Standards, but should strive to use its audits and reliability reports to anticipate reliability concerns on the Bulk-Power System and to consider the development of new Reliability Standards to avoid future blackouts.

230. We agree with FRCC that the relationship between section 300 and Appendix 1 is not clear. In its compliance filing, NERC must explain the relationship between the two documents.

231. All Reliability Standards NERC proposes to enforce must first be approved by the Commission. Further, all Reliability Standards approved by NERC's board must be submitted to the Commission for review and approval. Section 39.5(a) of the Commission's regulations requires the ERO to file each Reliability Standard or modification to a Reliability Standard that it proposes to be made effective with the Commission. Although the NERC application states that "Reliability Standards may, at the discretion of the board, be filed with applicable regulatory agencies in the United States, Canada and Mexico," the Commission presumes that this Rule concerns the ERO's relationship with entities in Canada and Mexico with regard to Reliability Standards. NERC also states that "[n]o Reliability Standard or revision to a Reliability Standard shall be effective within a geographical area over which an ERO governmental authority has jurisdiction unless approved by such governmental authority."[90] No Reliability Standard may be mandatory within the United States without first being filed with, and approved by, the Commission. To the extent SoCal Edison's request to modify step 10 of Appendix 1 is to require each proposed Reliability Standard approved by the board to be filed with all "ERO governmental authorities," we deny the request. Whether governmental authorities in Canada and Mexico require the ERO to file proposed Reliability Standards is not for this Commission to decide.

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[90] Rules of Procedure § 308.7.5.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

232. We reject Bonneville's suggestion that we require NERC to modify its proposed Reliability Standard implementation plan to include a timetable and a business plan for each Reliability Standard. NERC's Appendix 1 would provide that each proposed Reliability Standard will already incorporate a proposed effective date. Each Reliability Standard will take effect as approved by the Commission, and no Reliability Standard is enforceable before approval by the Commission. While NERC may propose a separate date in which sanctions may be imposed to allow lead time for the industry to adjust to a new Reliability Standard, we will not require on a generic basis that NERC identify a "sanction effective date" for each Reliability Standard. In regard to the request for a business plan, we note that NERC already proposes to incorporate into its Reliability Standard filings "a concise statement of the basis and purpose of the standard; the text of the standard; the implementation plan for the Reliability Standard; a demonstration that the standard meets the essential attributes of Reliability Standards as stated in section 302; the drafting team roster; the ballot pool and final ballot results; and a discussion of public comments received during the development of the Reliability Standard and the consideration of those comments."[91] We find that this is sufficient to cover the requirements specified in section 39.5(a) of the Commission's rules.

233. We also reject Bonneville's request that Reliability Standards expire unless they are re-approved. The five year review serves to assure that existing Reliability Standards are adequate, and Bonneville's proposal could cause unnecessary instability and a drain on ERO resources. Further, if a Reliability Standard is inadequate or has unintended consequences, under section 215(d)(5) and section 39.5(f) of our regulations, the Commission may, upon its own motion or a complaint, order the ERO to submit a modification to a Reliability Standard to address any specific concerns.

2. Technical Soundness

234. Reliability Standards, which must provide for an adequate level of reliability, must each be just, reasonable, not unduly discriminatory or preferential, and in the public interest.[92] Order No. 672 provides some general guidance regarding how the Commission will evaluate a proposed Reliability Standard to determine whether it meets this legal standard of review. For instance, a proposed Reliability Standard must be designed to achieve a specified reliability goal and must contain a technically sound means to achieve this goal. It 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 and should be based on actual data and lessons

[91] Rules of Procedure § 309.1.

[92] 16 U.S.C. § 824o(d)(2).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

learned from past operating incidents, where appropriate. Consideration of the Commission's review process should help inform the design of the ERO candidate's proposed Reliability Standard development process.

NERC Proposal

235. NERC's proposed Rules of Procedure describe ten characteristics for "technical excellence" that must to be met for approval of a Reliability Standard under development.[93] According to these Rules, a Reliability Standard must: (1) identify the types of entities and geographic scope to which it applies; (2) state its purpose and describe how it contributes to the reliability of the Bulk-Power System; (3) describe a specific performance requirement not resulting from lowest-common-denominator compromise, yet taking into account costs and benefits; (4) be measurable, so as to facilitate objective evaluation of compliance; (5) be based on engineering and operating judgment, analysis, or experience; (6) be complete and self-contained, independent of external information; (7) be clear as to the consequences for violation (when viewed in concert with the penalty guidelines); (8) use clear and unambiguous language; (9) consist of requirements that can be practically implemented; and (10) use consistent terminology.

236. NERC states that the purpose of a Reliability Standard, or its reliability objective, should derive from one or more of the following eight general objectives: (1) the Bulk-Power System should be planned and operated to perform reliably under normal and abnormal conditions; (2) the frequency and voltage of the Bulk-Power System should be controlled within defined limits by balancing real and reactive power supply and demand; (3) information necessary for the planning and operation of the Bulk-Power System should be made available to those who need it; (4) emergency operations plans should be developed and implemented; (5) facilities for communication, monitoring, and control should be provided, used and maintained; (6) personnel must be trained, qualified and must have the authority to implement actions; (7) the reliability of the Bulk-Power System should be monitored on a wide-area basis; and (8) the Bulk-Power System must be protected from malicious physical or cyber attacks.

Comments

237. Alcoa is concerned that NERC's application fails to define "adequate reliability" and does not develop metrics for analyzing the cost effectiveness of a Reliability Standard. It states that NERC's application neither defines the level of reliability it aims to achieve, which is a basic goal of the Reliability Standard development process, nor describes how its Reliability Standard development process would achieve this goal. Further, Alcoa states that the adequacy of the level of reliability is a statutory requirement. Alcoa asserts that the language in the Rules of Procedure, that each

[93] Rules of Procedure § 302.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Reliability Standard "shall state one or more performance requirements, which if achieved by the applicable entities, will provide for a reliable Bulk-Power System, consistent with good utility practices and the public interest,"[94] does not track the explicit language of FPA section 215 regarding the ERO's ability to develop Reliability Standards that provide for an adequate level of reliability.

238. Alcoa also argues that a Reliability Standard must be justified by weighing its incremental enhancement of reliability against its cost of implementation. It asserts that, although NERC includes a provision that each proposed Reliability Standard will contain a performance requirement that takes "account of the costs and benefits of implementing the proposal,"[95] it is not possible to assess whether the level of benefits provided by any proposed Reliability Standard is sufficient to achieve or surpass adequate reliability because NERC does not address this requirement in its application.

Commission Conclusion

239. The Reliability Standard development process must ensure that each Reliability Standard is technically sound and that its operational specifications are designed to achieve a valuable reliability goal.[96] We find that, by specifying the eight general objectives for which a Reliability Standard must be intended, NERC's proposed process meets this requirement of Order No. 672.

240. Although NERC's Rules of Procedure call for a specific performance requirement not resulting in a lowest common denominator compromise, a 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.[97] We agree with Alcoa that, unless NERC further explores what it means to provide an adequate level of reliability, targeting a valuable reliability goal may not be enough to prevent a Reliability Standard from reflecting the lowest common denominator. We are concerned that some process participants may support only those Reliability Standards that validate their current practices. However, we disagree with Alcoa that it is necessary to specify in advance a type of cost-benefit analysis for the ERO to apply uniformly to all Reliability Standards under development. Indeed, it is sufficient to understand that, while a Reliability Standard need not reflect the optimal

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[94] *Id.* § 302.3

[95] *Id.* § 302.3.

[96] Order No. 672 at P 258.

[97] *Id.* at P 329.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

method, or best practice, for achieving its reliability goal with regard to implementation cost, it should achieve its reliability goal effectively and efficiently.[98] Therefore, we direct NERC to consider and propose methods for ensuring that Reliability Standards provide for an adequate level of reliability and defining "an adequate level of reliability." For example, NERC should address the possibility that the super-majority voting requirement could, in some cases, allow a small portion of the industry to veto a standard that is designed to improve reliability or otherwise remedy flaws in an existing standard. Although we believe that a super-majority requirement is generally consistent with the nature of the ERO as a self-regulatory organization, we are concerned that, in certain instances, it could pose an obstacle to strengthening the reliability of the grid as envisioned by Congress in enacting section 215. NERC should address this possibility in its compliance filing.

241. In addition to pursuing a valuable reliability goal, the ERO's Reliability Standard development process should approve only a Reliability Standard that is just, reasonable, not unduly discriminatory or preferential, and in the public interest. Order No. 672 indicates that the Commission will consider a number of general factors when deciding whether a proposed Reliability Standard meets this legal standard of review. For example, a proposed Reliability Standard should be clear and unambiguous regarding what is required and who is required to comply.[99] So that enforcement can be applied in a consistent and non-preferential manner, there should also be clear criteria to measure whether an entity is in compliance with a proposed Reliability Standard.[100] NERC incorporates these and other factors into its proposed characteristics for technical excellence. We are persuaded that, as modified above, NERC's process will allow it to produce proposed Reliability Standards that generally meet the legal standard of review.

3. Notice, Opportunity for Comment, Due Process, Openness, and Balance

242. Section 39.3(b)(2)(iv) of the Commission's regulations requires the certified ERO to have established Rules that provide for reasonable notice and opportunity for public comment, due process, openness, and balance of interests in developing Reliability Standards.

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[98] *Id.* at P 328.

[99] *Id.* at P 262, 325.

[100] *Id.* at P 327.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC Proposal

243. NERC describes a specific process for developing Reliability Standards in its Rules of Procedures and sets out some overarching principles to guide both interpretation and revision of those Rules. NERC's proposed Reliability Standard development procedure will be implemented by a registered ballot body, administered by a standards process manager, and with oversight by a standards committee.

244. The registered ballot body will be the group of individuals that must first approve a Reliability Standard before it is sent to the board and then on to the Commission. Any person or entity with a legitimate interest in the reliability of the Bulk-Power System may join the ballot body and participate in the development of a Reliability Standard, whether or not they are a member of the ERO. Participants in the ballot body will be assigned to one or more stakeholder segments, depending on the nature of their interest in the Bulk-Power System.[101] An entity with operations or interests in more than one of these may join multiple segments.

245. As discussed earlier in this order, the standards committee will provide oversight of the Reliability Standard development process to ensure stakeholder interests are fairly represented. However, it will not be empowered to change the substance of a draft or approved Reliability Standard. NERC proposes to assign a standards process manager to be responsible for ensuring that the development and revision of Reliability Standards are consistent with NERC's Rules of Procedure. The standards process manager will focus on the integrity, quality and completeness of each Reliability Standard. The standards process manager will also coordinate the Reliability Standard development process with Regional Entities.

246. The Reliability Standard development process proposed by NERC would consist of seven major steps: (1) someone must request that a Reliability Standard be developed, modified or withdrawn; (2) NERC will request public comment on the scope and justification for the standard, and the standards committee will authorize development if there is consensus on these factors; (3) NERC will provide all government regulatory authorities notice that a Reliability Standard has been approved for development, and will also provide the regulatory authorities a plan and timetable for completing the process; (4), NERC will appoint a team of experts to draft the Reliability Standard. For each stage of the draft, NERC will provide public notice and the public will have the opportunity to

[101] As stated above, the segments defined by NERC are: (1) transmission owners; (2) RTOs, ISOs, and regional reliability organizations; (3) load serving entities; (4) transmission dependent utilities; (5) electric generators; (6) electricity brokers, aggregators, and marketers; (7) large electricity end users; (8) small electricity users; and (9) federal, state, and provincial regulators or other government entities.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

comment. This step of the process will continue until consensus has been reached on the Reliability Standard; (5) NERC may field test the Reliability Standard if it requires new methods or tools for implementation or to measure compliance; (6) drawing on volunteers from the registered ballot body, NERC will establish a separate ballot pool to vote on the proposed Reliability Standard; (7) members of the ballot pool will vote on the proposed Reliability Standard, votes to be tallied within each segment.

247. Should an expedited process for development of a Reliability Standard be required, NERC proposes to shorten the public notice and comment period. NERC would allow a minimum of 30 days before submitting a proposed Reliability Standard to a ballot pool for a vote. Also, any Reliability Standard approved through this expedited process—called the urgent action approval procedure—will automatically sunset after one year.

248. NERC proposes that it may sanction the Reliability Standard development process of a Regional Entity. After public notice and opportunity for comment, NERC will approve a Regional Entity Reliability Standard development process if it is open, inclusive, balanced, transparent, and provides due process. Alternatively, a process that is ANSI-accredited or duplicates NERC's process will be deemed acceptable.

Comments

249. FRCC states that, under the Reliability Standard development process, technical drafting teams are assigned responsibility for drafting a proposed standard. The Reliability Standard development process specifies that a draft Reliability Standard is to be electronically posted for public comment and that the drafting team is to consider all comments that are submitted. FRCC notes that there is no requirement for an opportunity for face-to-face dialogue with the drafting team by interested stakeholders. FRCC asserts that the Reliability Standard development process should be modified to provide for an open process that allows meaningful dialogue on a proposed standard.

Commission Conclusion

250. In order to be certified, NERC must demonstrate that it has established Rules that provide for reasonable notice and opportunity for public comment, due process, openness, and a balance of interests in developing Reliability Standards.[102] We find that NERC meets these requirements. NERC's proposed Rules of Procedure describe how it would notify and involve the public in developing a Reliability Standard. Participation in the development process would be open to any person or entity with a legitimate interest in the reliability of the Bulk-Power System. NERC's application also makes clear that it will consider the comments of all stakeholders and that a vote of stakeholders will be

[102] Order No. 672 at P 268, 270.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

required to approve a Reliability Standard for submission to the Commission. NERC must assure that the standards committee and the standards process manager coordinate all of the Reliability Standard initiatives to ensure that they are consistent with each other and with existing Commission-approved Reliability Standards, as appropriate.

251. Regarding FRCC's comment, we decline to require that NERC incorporate face-to-face meetings into the development process for each and every Reliability Standard. We recognize the value of face-to-face meetings and NERC, in its discretion, may choose to call an open meeting. However, we do not believe that they are necessary in every instance. A fair process of submitting written comments generally suffices.

252. Order No. 672 states that ANSI-accreditation is one reasonable means of meeting the Commission's requirements under section 39.3 of our regulations.[103] However, the Commission continues to be concerned about the time it may take to develop a Reliability Standard under NERC's current ANSI-certified process in certain circumstances, especially under a Commission-imposed deadline. Order No. 672 requires an ERO candidate to 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. NERC's application indicates that, under its proposed ANSI-accredited regular process a Reliability Standard may be developed in as little as four months or up to 12 to 15 months for a more complex standard. NERC states that an urgent action Reliability Standard might be approved within 60 days. Further, though quicker than its regular process, NERC's urgent action process does not appear to have a built-in mechanism for meeting a Commission-set deadline. We are also concerned about the one-year automatic sunset provision for a Reliability Standard developed through NERC's proposed urgent action process.

253. We do not believe that NERC's current processes adequately address the Commission's new authority under section 215 and, specifically, the authority to remand a standard or otherwise require that one be developed. There are three principal shortcomings in NERC's procedures in this regard that should be addressed in its compliance filing. First, it does not appear that NERC's procedures would allow the ERO to set a specific deadline for action by the standards development committees and registered ballot body in response to a Commission order that mandates action on a remand by a date certain. We therefore require NERC to develop such a process. Second, where expedited action is required, an urgent action standard can be adopted on an expedited basis, but it expires by its own terms within one year. This is not appropriate in situations where the Commission has required that a standard be modified or developed; there should be no possibility, in that circumstance, for the resulting standard to "lapse" or "expire." We therefore require that NERC adopt a process that

[103] *See id.* at P 269.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

provides for adopting an interim Reliability Standard on an expedited basis that is later subject to adoption on a permanent basis without any possibility that the interim standard "expires" in the interim. Third, in rare instances, the urgent action process may not be sufficiently expedited, such as if necessary to address an imminent threat to national security. We require NERC to address whether the urgent action process, or some other process, can accommodate any such rare circumstances.

4. Uniformity and Regional Reliability Standard Development

254. Reliability Standard uniformity should be the goal and the practice, the rule rather than the exception. However, this does not mean that regional differences cannot exist.[104] Order No. 672 requires the ERO to formally review a regional Reliability Standard proposed by a Regional Entity.[105] Section 39.5(b) of our regulations requires the ERO to 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. Sections 39.5(c)(1) and (2) provide that the Commission will give due weight to the technical expertise of the ERO with respect to the content of such a proposed Reliability Standard.

NERC Proposal

255. NERC proposes to differentiate between a regional Reliability Standard and a variance from a Reliability Standard. A regional Reliability Standard would not conflict with, or set a less stringent requirement than, a continent-wide Reliability Standard, but a variance would. In addition, regional criteria, which are not Reliability Standards and are not enforceable, are contemplated.

256. NERC proposes to allow variances when required by a physical difference in the electrical system or when a regulator-approved electricity market protocol or transmission tariff precludes adherence to a Reliability Standard. NERC must review any variance and decide whether to submit the variance to the Commission for approval. If the variance is to apply to an entity or group of entities smaller than a Regional Entity, it would be reviewed through NERC's normal Reliability Standard development process. If the variance is to apply to a Regional Entity, but less than a full Interconnection, it would be reviewed through NERC's normal process, but only ballot body members from the affected Interconnection would be able to join the ballot pool. If the variance is to apply to an Interconnection-wide Regional Entity, NERC would submit the variance to the Commission for approval if NERC found it to be just, reasonable, not unduly

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[104] *Id.* at P 291.

[105] *Id.* at P 654.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

discriminatory or preferential, and in the public interest. NERC would rebuttably presume that the variance meets these requirements if it were developed by an Interconnection-wide Regional Entity.

257. While NERC states that its intent is to promote uniform Reliability Standards across North America, where such uniformity is not feasible, practical, or economically justified, NERC may direct Regional Entities to develop regional Reliability Standards necessary to implement a NERC Reliability Standard. Regional Reliability Standards may also be used by Regional Entities to set more stringent reliability requirements or cover matters not addressed by an existing Reliability Standard. A regional Reliability Standard applicable to a Regional Entity not organized on an Interconnection-wide basis must be reviewed and approved through either NERC's Reliability Standard development process or through a regional process sanctioned by NERC. A regional Reliability Standard applicable to an Interconnection-wide Regional Entity will be presumed by NERC to be just, reasonable, not unduly discriminatory or preferential, in the public interest, and consistent with such other applicable standards of governmental authorities. However, this presumption may be rebutted. In either case, whether for Interconnection-wide or smaller Regional Entities, approved regional Reliability Standards will become part of the set of NERC-maintained Reliability Standards if approved by the Commission.

258. NERC proposes certain criteria which can be used to rebut its presumptions regarding variances and regional Reliability Standards for Interconnection-wide Regional Entities. According to NERC, the presumption can be rebutted by a finding that a regional Reliability Standard: (1) was developed through an unfair or closed process; (2) has adverse reliability or commercial impact on other Interconnections; (3) fails to provide a level of reliability, such that it would likely cause a serious and substantial threat to public health, safety, welfare, or national security; or (4) would create a serious and substantial burden on competitive markets not necessary for reliability.

259. NERC proposes that a regional Reliability Standard proposed to be applied to less than an entire Interconnection will not be presumed to be valid but may be demonstrated by the proponent to be valid in accordance with the following criteria: (1) provides a level of Bulk-Power System reliability that is adequate to protect public health, safety, welfare, and national security and would not have an adverse impact on the reliability of the interconnection or other regions within the interconnection; (2) is based on justifiable differences between regions, such as different electrical systems characteristics; (3) will not cause an adverse impact on commerce that is not necessary for reliability; and (4) was developed in a fair and open process that provided an opportunity for all interested parties to participate.[106]

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[106] Rules of Procedure § 313.4; Rules of Procedure, app. 1 at 25.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

260. NERC also proposes to allow Regional Entities to establish regional criteria. Regional criteria would not be incorporated into Reliability Standards and, therefore, would not be enforceable. However, regional criteria might be used by Regional Entities to implement or augment Reliability Standards, to address issues not within the scope of Reliability Standards, or to provide parameters, guidelines, or protocols for operations. NERC explains that regional criteria would promote more consistent implementation of the Reliability Standards, though they would not be Reliability Standards or regional variances.

Comments

261. NARUC and the New York Commission assert that the Commission should reject the requirement that proponents of a regional Reliability Standard intended to apply to a portion of an Interconnection demonstrate that the proposal is consistent with NERC's criteria as a prerequisite for adoption because it is inconsistent both with the text of EPAct and Order No. 672. NARUC and the New York Commission also claim that NERC's criteria go beyond the two categories of regional differences that should generally be accepted according to Order No. 672: (1) one 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 address; or (2) one that is necessitated by a physical difference in the Bulk-Power System.

262. ConEd requests that the Commission reject NERC's proposal to require that regional differences in Reliability Standards be approved by Interconnection-wide or continent-wide ballot bodies and to require a showing that regional differences for one region are inappropriate in other regions. ConEd states that regional differences would require an Interconnection-wide vote and would then have to be approved by a continent-wide ballot body because "[t]o the maximum extent possible, regional differences will be addressed through the NERC/ERO Reliability Standards development process" – which ConEd maintains would entail a continent-wide ballot body.[107] ConEd states that regional variances and regional Reliability Standards should be adopted by the stakeholders in the affected region. It states that the indifference of unaffected stakeholders outside of the region could frustrate the establishment of regional differences because there would not be a quorum of voters.

263. Several commenters assert that the requirement that the proponent of a regional difference demonstrate that "there is a justifiable difference between regions or subregions within the regional entity's geographic area"[108] improperly and unnecessarily

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[107] ConEd at 3, citing Transmittal Letter at 52-53.

[108] *Id.* at 4, citing Transmittal Letter at 53, n.18.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

circumscribes the adoption of regional differences.[109] They claim that this approach could threaten to perpetuate the regionalized approach that exists today and would bar regional differences with respect to circumstances and considerations that transcend a region and would inflexibly apply lowest-common-denominator Reliability Standards and bar regional initiatives that would otherwise serve the public interest. The commenters assert that if the stakeholders within a particular region place a higher value on reliability and support a regional difference that is more rigorous than the ERO Reliability Standard, they should be permitted to adopt that difference.

264. EPSA, however, recommends that the Commission provide guidelines to ensure that Reliability Standards are, to the maximum extent operationally feasible, developed within the ERO's Reliability Standard development process and uniformly applied on an Interconnection-wide basis. It asserts that, given the fact that each Reliability Standard, including one based upon and reflecting regional differences, must ultimately be reviewed by the ERO and approved by the Commission to become an ERO Reliability Standard, the ERO's own Reliability Standard development process should be the preferred mechanism through which regional Reliability Standards are developed.

265. PG&E and TAPS maintain that NERC's proposal is inconsistent with section 215 of the FPA because it includes the ability to enforce a regional Reliability Standard that may not have been approved by the Commission.[110] PG&E also asserts that the provision allowing enforcement of a Reliability Standard "accepted as mandatory within a particular region" will create uncertainty because it fails to clearly define how a regional Reliability Standard would be otherwise accepted as mandatory within a region. PG&E understands that this provision is intended to apply only to regions entirely within Canada where regional Reliability Standards may be enforced by the ERO once approved by provincial governmental authorities (that do not qualify as ERO governmental authorities) and argues that NERC should make this clear in the proposed procedures. TAPS notes that NERC's application allows regions to develop separate Reliability Standards that go beyond, add detail to, or implement NERC Reliability Standards that "exist separately from NERC Reliability Standards shall not be inconsistent with or less stringent than NERC Reliability Standards."[111]

266. TAPS further points out that by giving a Regional Entity the "option" to pursue NERC adoption of a regional Reliability Standard, NERC also gives the Regional Entity the option not to do so. TAPS claims that by opting not to pursue NERC approval, a

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[109] *See*, *e.g.*, EPSA and ConEd.

[110] PG&E at 26, citing Rules of Procedure § 313 (3.5), (4.5); TAPS at 18-23, citing Rules of Procedure § 202.13; 313.1.

[111] Rules of Procedure, app. 1 at 24; see also Transmittal Letter at 53.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Regional Entity leaves in place a regional Reliability Standard that would not necessarily be approved by NERC or the Commission. TAPS states that Congress created a single, top-down ERO which would set Reliability Standards for the continent, with regional difference accommodated through ERO- and Commission-approved regional Reliability Standards. Allowing a separate regional Reliability Standard without Commission review would prevent the Commission from evaluating the effects if such a standard on competition. Therefore, TAPS requests that the Commission require all regional Reliability Standards that cover matters within the Commission's jurisdiction be submitted for review to the ERO and Commission.

267. PG&E asserts that NERC's proposed procedures for ERO review of Interconnection-wide variances from Reliability Standards are vague and ambiguous. It states that when a regional variance is proposed by an Interconnection-wide Regional Entity, NERC's procedures impose the vague and ambiguous requirement that the ERO determine whether such regional differences are "consistent with applicable standards of governmental authorities." PG&E asserts that this requirement is inconsistent with the FPA and the Commission's regulations because, where an Interconnection-wide Regional Entity proposes a variation to be effective within that Interconnection, the ERO must rebuttably presume that the proposal is just, reasonable, not unduly discriminatory or preferential, and in the public interest. PG&E states that the ERO has no discretion to reject a regional difference if the presumption is not rebutted, which does not include the grounds that it is inconsistent with "unspecified standards of unspecified government agencies."[112] Further, it asserts that it is unclear which are the applicable standards or governmental authorities to which NERC refers.

268. TAPS states that it is concerned that NERC's proposal to have three categories of regional differences: regional Reliability Standards, regional variances, and regional criteria, is confusing, with overlapping and internally inconsistent definitions, and violates the statutory scheme because it does not create as uniform a set of ERO Reliability Standards as possible. TAPS asks the Commission to require NERC to propose a consistent definition of variance that is distinct from regional Reliability Standards. It states that in section 202.12 of the Rules of Procedure, a regional variance may not be inconsistent with the Reliability Standard it seeks to modify as it would otherwise exist without the regional variance. However, it asserts that this is inconsistent with section 313.1, which provides, in part, that "a variance would not be required . . . if the regional Reliability Standard does not conflict with or set less stringent requirements than any NERC Reliability Standard." To eliminate confusion, TAPS asserts that the Commission should require NERC to define and use the term "regional variance" consistently as the means to achieve justified exceptions to strict application of the otherwise applicable NERC standards

[112] PG&E at 25.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

269. TAPS also asks that the Commission require NERC to revise its application to better delineate the scope of regional criteria, so that they are clearly differentiated from regional Reliability Standards and from NERC interpretations of Reliability Standards.

NERC Reply Comments

270. In response to commenters' requests for clarification of the processes and criteria for approval of regional differences in Reliability Standards, NERC states that it implemented the Commission's provisions for regional differences in proposed sections 311-314 of the Rules of Procedure.

271. Pursuant to section 312, a variance would, for example, be required if a regulator-approved electricity market protocol or transmission tariff precluded meeting a reliability objective in the manner specified in a continent-wide Reliability Standard. A variance may also be needed because of a physical difference in the electric system.[113] An entity variance is a subset of this category, where needed for an entity smaller than a region. However, under section 313 of the Rules of Procedure, a regional Reliability Standard that does not require a variance from a NERC standard can exist in two circumstances: (1) the regional standard could be more stringent than the continent-wide standard, or (2) the regional standard could cover a matter not covered by an existing Reliability Standard. NERC asserts that both variances (section 312) and regional Reliability Standards (section 313) must be approved by both the ERO and the Commission before becoming enforceable.

272. Finally, NERC explains that section 314 of the Rules of Procedure provides for regional criteria that do not become Reliability Standards under section 215 of the FPA and are not enforceable under the FPA. Such criteria may be protocols for implementing Reliability Standards, or cover matters that are outside the scope of Reliability Standards under section 215. These criteria would not need to be approved by the ERO or the Commission.

Commission Conclusion

273. As directed by Order No. 672, NERC's proposed Reliability Standard development process provides Regional Entities the opportunity to consider and propose to the ERO regional differences in Reliability Standards

274. We believe that the criteria cited by NARUC and the New York Commission are unnecessary and could be confusing as applied to a regional difference to be applied to less than an Interconnection. The Commission has stated that we will accept the

[113] NERC states, for example, ERCOT has a variance for the control performance standard because it is a single balancing area within an entire Interconnection.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

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.[114] Section 215 of the FPA, the Commission's regulations and Order No. 672 already provide the criteria by which the ERO must evaluate a regional Reliability Standard. For instance, section 215 requires a Reliability Standard must promote the reliable operation of the Bulk-Power System, and Order No. 672 provides further factors to consider, including whether a regional difference is necessary or appropriate to maintain reliability and whether such a regional difference would affect reliable operation in another region.[115] Further, Order No. 672 provides two types of regional differences we would accept, whereas NERC states that each regional difference must be based on a justifiable difference between regions. This may cause confusion. For example, under the Commission's regulations, a Regional Entity should be able to demonstrate that a regional difference that is more stringent or addresses different matters than the continent-wide Reliability Standard is valid even where no difference between the regions exists. Finally, each regional difference is already required to be developed in fair and open process because it must be developed through the Commission-approved process for the ERO or that region. Therefore, we find that NERC's criteria are unnecessary and may create requirements for regional differences not dictated by the statute or the Commission's regulations. In its compliance filing, NERC must delete these criteria in both its Rules of Procedure and its Reliability Standard development procedures.

275. With regard to ConEd's comments, we decline to order NERC to change who votes on which regional difference to a Reliability Standard. NERC proposes that a variance proposed to apply to anything less than a full Interconnection must be approved through NERC's Reliability Standard development procedure. If the variance is proposed to apply to a Regional Entity that is less than a full Interconnection, only representatives from that Interconnection can vote. The Commission believes that this appropriately balances the interests of the Regional Entity proposing a regional variance with the other Regional Entities within that Interconnection because a regional variation that applies to only a portion of an Interconnection can have an effect on other regions within that Interconnection.

276. We disagree with ConEd that NERC's requirement for justification of a regional difference improperly circumscribes the adoption of regional differences. However, we also disagree with EPSA that all Reliability Standards must be developed through the

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[114] Order No. 672 at P 291.

[115] *Id.* at P 336.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

ERO's process and applied uniformly on an Interconnection-wide basis. The Commission prefers regional uniformity in Reliability Standards. However, as we said in Order No. 672, we will find regional differences acceptable if justified as being more stringent or necessary because of a physical difference in the system.

277. We agree with TAPS that regional Reliability Standards should not "exist independently from NERC Reliability Standards."[116] We also agree with PG&E and TAPS that allowing regional Reliability Standards "otherwise accepted as mandatory within a particular region" is not consistent with EPAct and our regulations.[117] Only a Reliability Standard (including a regional Reliability Standard or a variance) approved by the Commission is enforceable in the United States under section 215 of the FPA. However, we understand that NERC's intent with this language may be to accommodate the authority of certain Canadian governmental organizations. Therefore, NERC must either delete this phrase wherever it occurs in its Rules of Procedure or revise the language in its compliance filing to eliminate the ambiguity.

278. In regard to TAPS' additional comment, we do not believe that by giving a Regional Entity the option to seek NERC approval of a regional Reliability Standard, it is the intent of NERC to suggest that a Regional Entity could create its own set of voluntary regional reliability standards out of those it might not file with NERC. Rather, we believe that NERC meant only that the proponent of a regional Reliability Standard should have the option of withdrawing it from consideration or continuing to pursue it even in the face of opposition. We find this approach reasonable.

279. We disagree with PG&E and find that NERC's procedure for review of proposed Interconnection-wide variances is satisfactory. We understand "applicable standards of governmental authorities" to refer to Commission guidelines regarding the rebuttable presumption. While the ERO must rebuttably presume that the proposed variance is just, reasonable, not unduly discriminatory or preferential, and in the public interest, Order No. 672 clarified that this rebuttable presumption refers to the burden of proof before the ERO.[118] The ERO is still obligated to review every proposed Reliability Standard submitted to it by a Regional Entity. However, we note that one of NERC's criteria for rebutting the presumption afforded to Interconnection-wide Regional Entities is a finding that the regional Reliability Standard has an adverse reliability or commercial impact on other Interconnections. Section 215 states that the Commission will not defer to the ERO or a Regional Entity with respect to matters of competition. While the ERO may look at

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[116] Rules of Procedure, app. 1 at 24; *see also* Transmittal Letter at 53.

[117] *See, e.g.*, Rules of Procedure § 313.3.5.

[118] Order No. 672 at P 301.

competitve matters in evaluating a regional Reliability Standard, we note that the Commission's review of an ERO refusal to send such a standard to the Commission for approval on the basis of competition would be *de novo*.

280. We agree with TAPS that the distinction between a variance and regional Reliability Standard, as defined by NERC, is unclear. We also note that NERC's approach to developing, reviewing and approving such regional differences appears to be the same. Both types of differences require approval by NERC and become part of the NERC-maintained catalog of Reliability Standards. Both are due a rebuttable presumption by the ERO if proposed by an Interconnection-wide Regional Entity for that Interconnection. One difference lies in the fact that NERC would permit a regional Reliability Standard for economic reasons and a regional variance to accommodate market rules and tariffs. The basis for this distinction is not explained by NERC. Therefore we direct NERC to satisfactorily clarify in its compliance filing the definitions of all types of regional differences in Reliability Standards.

281. We disagree with TAPS that the definition and scope of regional criteria requires further clarification than provided by NERC in section 202.14 of its proposed Rules of Procedure. We understand regional criteria to be standards of behavior of a voluntary nature, for example, the method through which a region intends to implement a Commission-approved Reliability Standard. They are not enforceable under the FPA and they cannot preempt a Commission-approved Reliability Standard. We do however agree with TAPS that inconsistencies between regional criteria and Reliability Standards could lead to unnecessary confusion. Therefore, Regional Entities must avoid adopting any voluntary rules that detract from a Commission-approved Reliability Standard.

5. Remand of a Reliability Standard

282. Because the ERO will be an international organization, the Commission's regulations require an ERO candidate to propose in its 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.[119]

NERC Proposal

283. NERC proposes to respond to the remand of a Reliability Standard by notifying other regulatory authorities of the remand within five business days, reporting to all regulatory authorities a plan for modifying the Reliability Standard within 30 days, and then revising the Reliability Standard through its Reliability Standard development procedure (or through the urgent approval action procedure, if necessary).[120] NERC

[119] *Id.* at P 400.

[120] Rules of Procedure § 309.2

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

states that it intends to coordinate any impacts of the proposed Reliability Standard in other jurisdictions by consulting with other regulatory authorities throughout the revision process.

284. NERC proposes to provide a Reliability Standards annual work plan to all regulatory authorities during the initial Reliability Standard development phase. It will consider the comments and priorities of the regulatory authorities in developing and updating the work plan. Also, NERC will notify all regulatory authorities within five business days of each proposed Reliability Standard that it is directed to develop. Then within 30 days, NERC will report a plan and timetable for development of the Reliability Standard. NERC also proposes that the relevant governmental authorities enter into a memorandum of understanding detailing a cooperative approach to Reliability Standard development and approval.

Comments

285. International Transmission states that it is concerned that differing Reliability Standards on the interconnected Bulk-Power System on either side of the international border between the United States and Canada would be problematic. It recommends that the proposed memorandum of understanding include a more formalized framework to address a remand situation, detailing the steps that would be taken to resolve the issue, considering that the remand could occur in the United States or in Canada. It also asserts that NERC should emphasize this issue as part of its ongoing efforts to obtain recognition in Canadian provinces and with the National Energy Board.

Commission Conclusion

286. The Commission is also concerned about conflicting Reliability Standards across international borders but within the same interconnected Bulk-Power System. It is for this reason that Order No. 672 directs the ERO to propose an approach for international coordination regarding the initial development and remand of a Reliability Standard.[121] NERC's proposal is a good start but fails to provide sufficient detail. NERC suggests that the Commission enter into a memorandum of understanding with each relevant foreign government regulatory agency to embody a cooperative approach to remands. We believe that, as an international organization subject to multiple jurisdictions, it is incumbent on the ERO to manage the process of obtaining regulatory approvals in those jurisdictions. Therefore, we direct NERC to revise its proposed coordination process to: (1) identify the relevant regulatory bodies and their respective standards approval and remand processes that will be implicated in any remand of a proposed standard, and

[121] Order No. 672 at P 400.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

(2) specify actual steps to coordinate all of these processing requirements, including those that may be necessary for an expedited deadline to return a remanded proposed Reliability Standard.

6. Conflict with a State Action, and Contractual and Reliability Obligations

287. Section 39.6 of the Commission's regulations provides an opportunity for any transmission organization to seek Commission resolution of an apparent conflict between a Reliability Standard and a function, rule, order, tariff, rate schedule, or agreement accepted, approved or ordered by the Commission. Section 215(i) of the FPA authorizes the Commission to determine whether a state action to ensure the safety, adequacy, or reliability of electric service is inconsistent with a Reliability Standard.

NERC Proposal

288. NERC's proposed Rules of Procedure would require users, owners and operators of the Bulk-Power System to notify NERC and any relevant regulatory authority of any conflict between a Reliability Standard and a function, rule, order, tariff, rate schedule, legislative requirement, or agreement.[122] NERC would then advise the regulatory authority if requested. Until otherwise ordered by the regulatory authority, users, owners and operators must continue to follow the function, rule, order, tariff, rate schedule, legislative requirement or agreement.

Comments

289. The California Commission states that it continues to be concerned that state and regional resource adequacy and transmission planning initiatives could be preempted by being found "inconsistent" with Reliability Standards, or by being found via assessments of "teams of experts" (or "industry experts") to inadequately protect reliability. The California Commission asks that state and regional actions be judged for consistency against those Reliability Standards applicable in those states and regions. For example, it states that NERC should monitor compliance with the standards applicable in that particular region or state, taking into account any variance or variations.

290. The California Commission also states that NERC should make clear that the results of the ERO's assessments of Bulk-Power System reliability and adequacy, including the ERO's assessments of regions' self-assessments, cannot provide the basis for preempting state or regional transmission planning and resource adequacy programs.

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[122] Rules of Procedure § 315.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission Conclusion

291. In regard to the California Commission's concerns regarding state resource adequacy and transmission planning initiatives, as we stated in Order No. 672, we do not believe that it is necessary to develop generic guidelines on the consistency between such initiatives and Reliability Standards.[123] Rather, we will carefully consider at the time when a specific Reliability Standard is before us whether it falls within the ERO's and the Commission's reliability jurisdiction. When reviewing a state action for consistency, we intend to continue to respect the states' roles in transmission planning and to judge consistency with respect to all relevant Reliability Standards.

292. We agree with the California Commission that the ERO's assessments of Bulk-Power System reliability and adequacy cannot themselves provide the basis for preempting state or regional transmission planning and resource adequacy programs. The Commission can, however, order the ERO to submit adequacy assessments, including recommendations that some entities are found to have inadequate resources.[124] In addition, our regulations provide for a determination of consistency between state actions and a Reliability Standard, as well as an assessment of the Reliability Standard's effectiveness as the Commission may deem appropriate.

E. Enforcement of Reliability Standards

293. An ERO candidate 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.[125] The ERO and Regional Entities are expected to have a compliance program for ongoing monitoring of user, owner and operator compliance with Reliability Standards.[126] The ERO and Regional Entity enforcement process must include these elements: (1) a compliance program that includes proactive compliance audits to determine if users, owners and operators of the Bulk-Power System are complying with Reliability Standards; (2) an investigation program for alleged violations of Reliability Standards wherein the ERO informs the Commission promptly of these incidents and their dispositions; and (3) a penalty program wherein a penalty may be assessed (non-monetary or monetary) subject to Commission review.[127]

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[123] Order No. 672 at P 814.

[124] *Id.* at P 805-06.

[125] *Id.* at P 129.

[126] *Id.* at P 456.

[127] *Id.* at P 45.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

294. The ERO may delegate its enforcement responsibilities to a Regional Entity, but the ERO must retain oversight responsibility for enforcement authority that is delegated.[128]

1. General

NERC Proposal

295. NERC proposes to establish and implement a enforcement program, as set forth in section 400 of its proposed Rules of Procedure, to promote the reliability of the Bulk-Power System by enforcing compliance with approved Reliability Standards in those regions of North America where NERC and/or a Regional Entity has been delegated authority.[129] The components of the ERO enforcement program will include: (1) the ERO's oversight of the Regional Entity programs; (2) a description of the Regional Entity enforcement program attributes; (3) the ERO's monitoring of Regional Entity compliance with Reliability Standards; and (4) the monitoring of compliance with Reliability Standards that are applicable to the ERO. To meet the goals and requirements of the ERO enforcement program, each Regional Entity enforcement program must include all attributes of the ERO enforcement program.

Comments

296. EEI, ESI and other commenters request that the Commission: (1) conditionally accept NERC's proposed enforcement program; (2) order NERC to make a compliance filing to correct parts of its application that do not currently meet Order No. 672 requirements, including a lack of specific procedures that would meet the Commission's own due process and consistency requirements, as well as a timetable and procedures, specified in section 403.3.2 of the Rules of Procedure, for ensuring consistency between Regional Entity compliance programs and between ERO and Regional Entity compliance programs; and (3) prohibit the imposition of penalties until NERC's enforcement processes meet due process requirements. In particular, EEI and Ameren believe that NERC's scattering of enforcement provisions throughout its application and proposed Rules hinders identification of steps in proposed enforcement processes and determination of whether different processes are complete, consistent and afford due process. EEI asks the Commission to determine a schedule under which it will require NERC to describe clearly the enforcement process from the triggering event through the appeal process at the ERO level.

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[128] *Id.* at P 47.

[129] Rules of Procedure § 401.

297. APPA lists several apparent drafting errors in section 400 of NERC's proposed Rules of Procedure and asks the Commission to correct them.

298. Asserting that because the Commission intended in Order No. 672 that Regional Entities be subsidiary to, and, in fact, simply extensions of, the ERO, ELCON asks that the relationship between NERC and Regional Entities be clarified to provide NERC with strong top-down authority and to promote uniformity in enforcement of Reliability Standards.

Commission Conclusion

299. We accept NERC's ERO enforcement program, subject to the condition that NERC submit a compliance filing that includes all amendments, clarifications and additional submissions we require in this portion of the order. We agree with EEI that the specific steps and triggers of the audit and other enforcement processes are not clearly set forth in any one place in NERC's application. Accordingly, NERC's compliance filing must include the specific procedures, similar to those to which NERC refers in proposed section 402.3 of the Rules of Procedure, under which it will use its authority as ERO to ensure consistency and fairness in Regional Entity programs with respect to findings relating to compliance and imposition of monetary penalties, non-monetary penalties and remedial actions. The procedures must also apply to NERC's own enforcement program with respect to Regional Entities. We decline to establish a timetable by which NERC should implement these procedures, but direct NERC to propose a timetable in its compliance filing that will ensure that all elements of the enforcement process, including the Sanction Guidelines that provide for assessment of monetary and non-monetary penalties, are approved and implemented by the date on which the Commission will permit the ERO and Regional Entities to begin assessing actual penalties.

300. As discussed elsewhere in this order, we agree that the ERO and each Regional Entity, using authority delegated by the ERO pursuant to FPA section 215 and our regulations, may enforce only a Reliability Standard, including a regional Reliability Standard or a variation, that the ERO and the Commission has approved.

301. We direct NERC to make the corrections to drafting errors suggested by APPA, to the extent they remain applicable to NERC's compliance filing.

2. Compliance and Readiness

302. Enforcement includes both proactive compliance efforts by the ERO or a delegated Regional Entity as well as after-the-fact investigations and imposition of penalties.[130] The ERO or a Regional Entity may not only take a remedial action and

[130] Order No. 672 at P 45.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

direct a user, owner or operator to come into compliance with a Reliability Standard, but may also assess penalties, both non-monetary as well as monetary, either in conjunction with, or after, action to bring an entity into compliance.[131] Compliance includes activities such as audits, best-practices programs and remedial actions.

303. The audit program consists of rigorous review of each user, owner and operator of the Bulk-Power System through two different types of audits, one of which assesses compliance and one of which assesses the capability to comply. A compliance audit determines whether a user, owner or operator of the Bulk-Power System is in compliance with all applicable Reliability Standards through an independent audit that may result in the assessment of a penalty for a violation of a Reliability Standard. As discussed in Order No. 672, a reliability readiness review uses peer review and mutual assistance in order to assess the readiness of a user, owner or operator of the Bulk-Power System, such as a balancing authority, transmission operator or other entity, by providing guidance to help both the audited entity and other entities to improve.[132] Evidence of a violation of a Reliability Standard discovered during a readiness audit will not result in the immediate imposition of a penalty. Instead, reliability readiness review teams report such evidence to the enforcement program for investigation. We discuss each audit program separately below.

a. Compliance Audits

304. An effective enforcement audit program is a necessary component of the requirement that the certified ERO has the ability to develop and enforce Reliability Standards.[133] Section 39.7(a) of the Commission's regulations requires the ERO and Regional Entities to develop a single audit program that provides for rigorous audits of compliance with Reliability Standards by users, owners and operators of the Bulk-Power System. Order No. 672 intends 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.[134]

NERC Proposal

305. A major attribute of NERC's proposal is compliance audits by Regional Entities of Bulk-Power System users, owners and operators, as defined by the NERC enforcement

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[131] *Id.* at P 478.

[132] *Id.* at P 467.

[133] *Id.* at P 463.

[134] *Id.* at P 464.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

program. NERC intends the Regional Entity compliance audits to be a process in which a Regional Entity performs a detailed review of users, owners or operators of the Bulk-Power System to determine whether they are in compliance with approved Reliability Standards. Each Regional Entity will perform compliance audits of Bulk-Power System owners and operators with primary responsibility for reliability at least once every three years, and will perform the audit for other users, owners and operators of the Bulk-Power System on a schedule the ERO will establish.

306. A Regional Entity will perform audits of compliance with Reliability Standards identified by NERC. It will also review supporting documentation and evidence submitted for self-certification compliance reporting since the previous compliance audit. NERC intends that any applicable governmental authority may participate on an audit team as an observer within its jurisdiction, at the governmental authority's discretion, subject to limitations on audit team size.

Comments

307. EEI believes that NERC's Rules of Procedure should clearly set forth the audit process, including the scope of audits, information and interview requests, preparation and review of draft and final audit reports, and consistency reviews by ERO or Regional Entity staff. EEI suggests that NERC's Rules of Procedure describe an audited entity's due process rights with respect to information requests, the entity's participation in the audit and interviews, the entity's right to review and comment on draft audit reports and provide additional information, the right to review certain issues raised by Regional Entity compliance staff, appeal rights, and procedures for maintaining the confidentiality of information, at least until approval of a final audit report. In particular, EEI contends that proposed sections 403.11 and 403.12 of the Rules of Procedure do not provide any detail about due process requirements that apply to compliance audits. According to EEI, this lack of detail impairs comparisons between procedures for compliance audits, findings of alleged violations, and the much greater detail about due process for reliability readiness reviews pursuant to Rules of Procedure section 700.

308. FRCC disagrees with NERC's proposal to monitor actively only a subset of Reliability Standards annually; FRCC would require some type of active annual monitoring for all standards. FRCC suggests that NERC use FRCC's self-certification process in which each registered entity either certifies in writing full compliance for each applicable standard or explains in detail why it is not complying.

309. WECC urges the Commission to determine that Regional Entities, as a delegated function, implement auditing procedures, including control over the schedule and type of audits conducted. WECC proposes to continue to audit control areas, balancing authorities, transmission operators and reliability coordinators every three years, but questions whether audits of distribution entities or small generators to which a small

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

number of Reliability Standards apply would enhance reliability. WECC also supports conducting compliance audits immediately after reliability readiness reviews to avoid multiple visits during the year.

310. ELCON seeks clarification that the ERO enforcement program is independent of the entity subject to possible enforcement action and that no employee shall be permitted to audit or monitor any entity that pays the employee. ELCON requests that NERC's Rules of Procedure be revised to require NERC compliance staff to participate in all Regional Entity audit teams. ELCON finds proposed sections 403.1, 403.6, 403.11.4, and 405 of the Rules of Procedure to be inadequate to ensure that compliance will be independent and uniform.

311. EEI asks for information on the training NERC or a Regional Entity would provide to industry experts and Regional Entity members who participate in audits or investigations, pursuant to proposed section 403.7.5 of the Rules of Procedure. EEI also asks whether NERC has a compliance audit procedures manual and, if so, comments that NERC should submit it for Commission review.

312. Entergy requests that the Commission ensure that the compliance audit process incorporates adequate due process.

Commission Conclusion

313. The NERC application does not explicitly propose a single compliance audit program applicable to both the ERO and each Regional Entity as required by section 39.7(a) of the Commission's regulations.[135] Rather, NERC intends that each Regional Entity will administer a Regional Entity enforcement program in accordance with the goals and requirements of the ERO enforcement program. As discussed elsewhere in regard to the *pro forma* delegation agreement, uniformity among Regional Entity programs is important to provide fairness. Accordingly, we direct NERC to include in its compliance filing either a single compliance audit program or a plan and a timetable for developing such a program. If NERC believes that certain differences among the regions are appropriate, such as where a particular region develops a program that is superior in certain respects to the standardized program, it should so explain these differences in its compliance filing.

314. NERC proposes that the ERO compliance staff may participate in Regional Entity audits of compliance with Reliability Standards by Bulk-Power System users, owners and operators, at the ERO's discretion. In addition, NERC proposes that the ERO select Reliability Standards for which a Regional Entity will perform compliance audits, and then monitor the Regional Entity's audits. Although the ERO staff's required

[135] *See* Order No. 672 at P 46, 463-64.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

participation with Regional Entity personnel in every compliance audit could facilitate more uniform compliance audits, we accept NERC's proposed discretionary role in Regional Entity compliance audits until there is an indication that the compliance audits are not sufficiently uniform. We believe that WECC's proposal that a Regional Entity decide the schedule and type of compliance audits that it performs would grant too much discretion and impede the ERO's efforts to take an active leadership role and to achieve uniformity in compliance audits.

315. Each Regional Entity's enforcement program must exhibit independence as a required attribute. Contrary to ELCON's view, we believe that NERC's Rules of Procedure provisions adequately address the "independence" requirement for due process relating to Regional Entity compliance audit teams. We find acceptable NERC's prohibition on any audit team members having an interest in the outcome of the audit in accordance with sections 403.6.3 and 403.6.5 of the Rules of Procedure. NERC also appropriately requires in section 403.1 of the Rules of Procedure that Regional Entity compliance staff not be unduly influenced by Bulk-Power System users, owners and operators.

316. In order to ensure consistency throughout the audit process, the Commission requires all audits to be conducted in accordance with generally accepted government auditing standards as set forth in the *Government Auditing Standards*.[136] We conclude that NERC's proposed training program for all participants in compliance audits, with more comprehensive training given to audit team leaders, is sufficient to help assure the independence of the Regional Entities' compliance audit function.

317. The Commission finds acceptable the three-year cycle for a Regional Entity's compliance audit process, and denies FRCC's suggestion that an annual audit cycle would better ensure uniformity. We disagree with FRCC's suggestion to require an active annual monitoring of all Reliability Standards, because annual compliance audits could be overly burdensome or lead to overreliance on self-certification. Moreover, FRCC states that its annual audit cycle primarily employs self-certifications of compliance.

318. During compliance audits of Bulk-Power System users, owners and operators, constraints may not be placed on the Commission staff's participation in the audit process. Therefore, we direct NERC to revise section 403.11 of its Rules of Procedure,

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[136] *Government Auditing Standards (2003 Revision)*, GAO-03-673G, June 2003, *available at* http://www.gao.gov/govaud/ybk01.htm. We expect NERC to update the ERO and Regional Entity audit program in light of any subsequent revisions.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

to remove references to limiting Commission staff participation on an audit based on team size. To the extent there are other such limitations, NERC should delete them in the compliance filing.

b. Reliability Readiness Reviews

319. Order No. 672 orders that the certified ERO develop readiness audit programs with an implementation schedule and make a compliance filing no later than one year from the date of certification.[137]

NERC Proposal

320. NERC proposes a reliability readiness review and improvement program (reliability readiness program) that would promote compliance with Reliability Standards and enhance the reliability of the Bulk-Power System.[138] The reliability readiness program would identify entities with primary reliability responsibilities and provide guidance to help those entities achieve operational excellence. NERC intends to use the results of the reliability readiness reviews to improve reliability performance of these entities and achieve excellence in their assigned reliability functions and responsibilities.

321. While the reliability readiness reviews are intended to enhance reliability and promote excellence, not to determine whether an entity is complying with specific Reliability Standards, if a reliability readiness review finds evidence of possible noncompliance with a Reliability Standard, the review team will report the evidence to NERC for resolution through an investigation. If the matter is an immediate threat to reliability, the review team will notify the Regional Entity and NERC within 24 hours of discovery.

Comments

322. NPCC and Alcoa argue that the reliability readiness review program falls outside the activities authorized by FPA section 215. ISO/RTO Council asserts that NERC's proposed program exceeds the ERO's statutory authority because such reviews are unrelated to assessing compliance with Reliability Standards. Bonneville, ISO/RTO Council and Progress believe that the Commission should place efforts to promote excellence in reliability in an INPO-like organization outside the ERO to avoid any conflict of interest that might arise in an organization tasked both to enforce compliance and to provide services to aid in compliance.

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[137] Order No. 672 at P 468.

[138] Rules of Procedure § 701.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

323. According to ISO/RTO Council, the Commission should defer approval of the reliability readiness program until NERC submits a complete business plan, budget and explanation for the program. FRCC suggests that if the ERO wishes to use statutory procedures for a "best practices" program, it should incorporate a "best practice" into the relevant Reliability Standard. Otherwise, FRCC believes that the reliability readiness review program will lead to best practices that create *de facto* reliability standards that exceed NERC's statutory authority for setting Reliability Standards. In FRCC's view, reliability readiness reviews will shift the focus to how entities comply, from whether they have complied, and will pressure entities to comply with Reliability Standards in a certain manner. NPCC posits that NERC should be required to justify the reliability readiness program and reliability assessment activities as benefiting reliability and explain how they do not inhibit NERC's functions pursuant to FPA section 215.[139]

324. Progress asks that the Commission reject NERC's proposal to institutionalize the reliability readiness program. While acknowledging its usefulness after the August 2003 blackout, Progress emphasizes that the program was developed by NERC staff without industry input or approval and could result in ad hoc formation of "best practices" for compliance with Reliability Standards without such input or approval.

325. EEI requests clarification of section 700 of the proposed Rules of Procedure and proposed Appendix 7 to the Rules of Procedure because their procedures for reliability readiness reviews do not appear to be consistent.

326. Alcoa asserts that use of volunteer industry representatives on audit teams tasked to identify and report to NERC possible noncompliance with Reliability Standards, particularly reliability readiness review teams, could undermine audit independence and should be prohibited absent appropriate safeguards. International Transmission suggests that the majority of reliability readiness review team members be NERC-certified shift operators to assure the greatest possible acceptance of audit results. International Transmission also proposes that, at the completion of an on-site reliability readiness review, the audited entity should receive a copy of any report of evidence of possible noncompliance with a Reliability Standard that the team is required to provide to NERC.

327. Bonneville makes the following suggestions concerning the pre-audit items for reliability readiness reviews listed in Appendix 7: (1) "pre-audit items" should be renumbered to reflect their chronological order; (2) pre-audit item 2 should be revised to provide that the ERO will send a questionnaire to operating entities with which the audited entity interacts; (3) pre-audit item 1 should be amended so that it does not refer to both the "posting" and "issuance" of a final audit report; and (4) under "Mediation by a Neutral Party," items five and six should be amended to permit a mediator seven calendar

[139] NPCC at 6-7.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

days after mediation to prepare a written recommendation to the parties, rather than requiring the mediator to propose a solution on the day of the mediation, and to allow parties seven calendar days to accept the mediator's recommendation or pursue an appeal.

328. EEI notes that a detailed appeal process is provided for reliability readiness reviews, including an opportunity for arbitration, and asks NERC to explain why an equally detailed appeal process is not provided for compliance audits. EEI also asks for a description of the NERC dispute resolution process under which an entity that receives a reliability readiness review may seek adjudication of disputed review findings or recommendations. International Transmission comments that NERC should clarify that mediators used in appeals of reliability readiness reviews will follow American Association of Arbitrators rules and that any mediation proceeding will be confidential.

329. Alcoa asserts that the appeal procedures for reliability readiness review findings do not protect against potential bias against the appellant. International Transmission seeks clarification that the ERO compliance and certification committee will be involved in the reliability readiness review process, and further seeks information on the committee's composition. Because NERC's reliability readiness review procedures provide that the ERO board of trustees will be the forum of last resort for disputes relating to the program, and the NERC Bylaws would provide that the board generally acts by majority vote, International Transmission seeks clarification whether the majority vote requirement would apply to the board's actions on appeals of reliability readiness reviews.

330. ISO/RTO Council, National Grid and Georgia Operators believe that a reliability readiness review team's report should not be publicly disclosed until the appeal process for the report is complete, to parallel the non-disclosure process for penalties.

Commission Conclusion

331. The reliability readiness review program is similar to, if not the same as, the program that the NERC board of trustees approved after the August 14, 2003 Northeast blackout. The reliability readiness review program, as described in the NERC February 10, 2004 board of trustees meeting minutes, is "one of four strategic initiatives by NERC and the Regional Reliability Councils to strengthen compliance with existing standards and to formally track completion of recommended actions from the August 14, 2003 blackout, and other significant power system events." Additionally, EEI commented as an observer to that meeting that the EEI Chief Executive Officers "strongly support the [reliability] readiness [reviews] and [Commission] oversight." EEI also emphasized the need to demonstrate that the industry stands behind NERC.[140]

[140] NERC February 10, 2004 Board of Trustees Meeting Minutes, Exh. J.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

332. As previously stated, the Commission believes that enforcement includes proactive compliance efforts by the ERO and each Regional Entity. We believe that reliability readiness reviews are an important facet of these proactive efforts to maintain a reliable Bulk-Power System. As such, we reject arguments that reliability readiness reviews are outside the scope of NERC's statutory activities. Further, we reject arguments that NERC must establish at this time an INPO-type program that is completely separate from the ERO. Additionally, based on NERC board of trustee meeting minutes and industry comment, we also dismiss Progress' argument that the readiness audit program should be rejected because of Progress' misplaced understanding that the program was created without industry input or approval.

333. With regard to ISO/RTO Council's comment, we find that NERC's proposal provides sufficient detail and, therefore, that there is no need to delay approval until NERC submits a business plan. In Order No. 672 the Commission stated that the ERO must propose a reliability enhancement program no later than one year from certification.[141] Further, we reject ISO/RTO Council's contention that the reliability readiness review program should not be employed because it will lead to confusion between Reliability Standard compliance requirements and industry best practices because of the benefit of a hands-on review. We also disagree with FRCC that best practices identified though the reliability readiness reviews will become *de facto* standards. Reliability Standards are mandatory and enforceable and the inclusion of voluntary best practices would run counter to that goal. ISO/RTO Council's concern that reliability readiness reviews will pressure entities to comply with a Reliability Standard in a specific manner is speculative, and experience with NERC's past voluntary readiness audits does not bear this out.

334. EEI asks for clarification of inconsistencies between section 700 (Reliability readiness review and Improvement) and Appendix 7 (Readiness Audit Procedures) of the Rules of Procedure. EEI does not provide any specific examples. While it appears that Appendix 7 provides greater specificity regarding how a reliability readiness review will be conducted, NERC must explain in its compliance filing the relationship between the two provisions, remove inconsistencies and/or explain and make clear which section prevails if there is an inconsistency.

335. EEI and others are concerned about differences in the appeal process set forth for the reliability readiness program in comparison to other aspects of the enforcement program. The Commission finds that significant differences and levels of detail exist and directs NERC to explain the need for differing appeal procedures. Further, NERC should explain the need for arbitration with regard to the reliability readiness reviews.

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[141] Order No. 672 at P 468.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

336. A number of commenters, including International Transmission, EEI, Alcoa and Bonneville recommend that changes be made to the procedures of NERC's proposed reliability readiness program to ensure adequate due process safeguards. We view the program as containing sufficient safeguards to ensure due process. In regard to ISO/RTO Council and others that a report involving unconfirmed violations should not be publicly disclosed until the appeal process is complete, we note that compliance audits, not reliability readiness reviews, involve the reporting of violations. We note that NERC's application clearly states in regard to compliance audits that unconfirmed violations should not be made public.

337. We do not agree with International Transmission's suggestion to require the majority of reliability readiness review team members to be NERC-certified shift operators or require two ERO-certified shift operators' participation when no other team member is NERC-certified. However, reliability readiness review team members must receive appropriate training and have expertise that qualifies them to conduct reliability readiness reviews.[142] To ensure the independence of reviews, the Commission requests that NERC explain in its compliance filing the composition of the proposed ERO compliance and certification committee. Additionally, the Commission directs NERC to clarify the voting requirement that applies to appeal bodies throughout the appeal process for the reliability readiness program.

338. Accordingly, we accept NERC's proposed reliability readiness program, subject to the compliance filing discussed above. We note, however, that the Commission still expects NERC to make a compliance filing no later than one year from the date of certification proposing other types of reliability enhancements that would improve Bulk-Power System reliability, along with a program implementation schedule, as discussed in Order No. 672.[143]

c. ERO Oversight of Regional Entity Enforcement Programs

NERC Proposal

339. NERC proposes to maintain oversight of Regional Entity compliance efforts by developing and maintaining a program to monitor the enforcement programs of Regional Entities with delegated authority. NERC states that its program will ensure that each Regional Entity conducts its enforcement program in accordance with the required elements and that the outcomes and administration within and among all Regional Entity enforcement programs are consistent and fair. Each Regional Entity will submit for NERC approval an annual enforcement implementation plan that would identify, in addition to the monitoring required by NERC, the Reliability Standards and requirements

[142] Order No. 672 at P 175, 178.

[143] *Id.* at P 468.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the Regional Entity would actively monitor and how each such standard or requirement would be monitored, evaluated, reported, sanctioned or appealed. Each Regional Entity shall report to NERC on how the Regional Entity carried out its delegated enforcement authority during the previous year, the effectiveness of the program, any deficiencies uncovered, and changes to correct such deficiencies. NERC will use an annual enforcement review, program audits, and regular evaluations of the performance of each Regional Entity enforcement program to accomplish oversight and to maintain consistency. Where differences occur in Regional Entity program methods, including determination of violations and penalty assessment, NERC will justify them on a case-by-case basis and will document them fully.

340. NERC states that it will evaluate annually the effectiveness of the goals, tools and procedures of each Regional Entity enforcement program, using criteria developed by NERC's compliance committee of stakeholders. At least once every three years, NERC will conduct an audit to evaluate how each Regional Entity's enforcement program implements NERC's enforcement program. NERC will provide these evaluations to the appropriate governmental authorities.

341. A NERC stakeholder compliance committee will monitor NERC's compliance with Reliability Standards that apply to NERC, using independent monitors with no conflict of interest, real or perceived, in the outcome. All violations determined as a result of the monitoring would be made public.

342. NERC will undergo an independent audit of its enforcement program at least once every three years, or more frequently as determined by its board of directors. In addition to any other requirements established by the board, the audit would address the success and effectiveness of the NERC enforcement program in achieving its mission and ensuring reliability and evaluate the relationship between NERC and the Regional Entity enforcement programs.

Comments

343. EEI believes the ERO must ensure that Regional Entity enforcement processes are consistent and meet the requirements set by the Commission. Likewise, ELCON and ESI believe that NERC must clarify how consistency between Regional Entities will be maintained. ReliabilityFirst also supports uniformity and consistency among Regional Entities.

344. Allegheny finds NERC's proposed three-year cycle of audits for Regional Entity enforcement programs to be inadequate to verify compliance with NERC's Rules of Procedure and Regional Entity delegation agreements or to promote consistent interpretations of Reliability Standards and comparable penalties across regions. Allegheny proposes that NERC audit Regional Entities at least annually.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

345. National Grid submits that NERC's proposal to audit Bulk-Power System users, owners and operators operating within a particular Regional Entity to verify findings of the Regional Entity's previous compliance audits represents an inefficient use of limited audit resources. According to National Grid, these indirect verification audits would put an unnecessary burden on users, owners and operators who would need to provide verification through responses to data requests.

346. EEI asks the Commission to establish a schedule for completion of: (1) NERC's plan to assure continuity of compliance monitoring and enforcement if a Regional Entity does not have a delegation agreement, withdraws from such an agreement or does not comply with the agreement's other applicable requirements, as provided in section 401.5 of the Rules of Procedure; (2) the program NERC promises in section 402.1 to monitor Regional Entities' enforcement programs; and (3) the program NERC mentions in section 402.3.2 to ensure the consistency and fairness of Regional Entity enforcement programs and penalties. EEI requests guidance on the schedule for Regional Entities to submit to the ERO annual enforcement implementation plans and annual reports on the previous year's implementation of delegated enforcement authority, pursuant to proposed section 403.20. EEI also asks for clarification on the management procedures NERC proposes for itself and Regional Entities in section 402.4 of the Rules of Procedure that address data reporting requirements, data integrity, data retention, data security and data confidentiality.

347. EEI requests that the Commission require NERC to eliminate references in its proposed Rules of Procedure to the ERO's enforcement of Reliability Standards applicable to a regional reliability organization or Regional Entity. With the exception of any initial Reliability Standards that require a Regional Entity to develop particular standards, EEI believes that a Regional Entity (or regional reliability organization) should not be subject to Reliability Standards.

348. Observing that proposed section 405 of the Rules of Procedure states that a "stakeholder compliance committee" will oversee NERC's compliance with Reliability Standards that apply to it, EEI asks that NERC identify any such standards and state whether they would include NERC's proposed Rules of Procedure.

NERC Reply Comments

349. NERC asserts that to the extent commenters raise questions concerning the compliance programs of the Regional Entities, those questions should be dealt with in the context of the review of the Regional Entity compliance programs as part of the overall review of the proposed regional delegation agreements.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission Conclusion

350. We share the concern of EEI, ELCON and other commenters regarding the need for uniformity and standardization with regard to the enforcement processes of the ERO and each Regional Entity. In Order No. 672, the Commission emphasized the need for such consistency, and we continue to believe that uniformity of procedures among Regional Entities is necessary for fairness. As discussed in greater detail with regard to the *pro forma* delegation agreement, the Commission expects NERC and the Regional Entities to develop uniform enforcement procedures that will be included in Regional Entity delegation agreements. Deviations from the uniform procedures must be highlighted and justified, such as where the deviation provides a practice that is superior to the standard practice.

351. Allegheny asks that NERC shorten the cycle of auditing each Regional Entity from three years to one year. National Grid comments that NERC's proposal to conduct verification audits is an inefficient use of resources. We find that NERC's proposal is acceptable in these areas. In particular, the three-year audit cycle for ERO audits of Regional Entities aligns with the three-year cycle of Regional Entity compliance audits of users, owners and operators of the Bulk-Power System. If NERC determines in the future that its Regional Entity audit procedures do not provide sufficient oversight or are inefficient, it may seek to modify them.

352. EEI asks the Commission to establish a schedule for the completion of several programs mentioned in NERC's Rules of Procedure, guidance on the schedule for Regional Entities to submit to the ERO annual enforcement implementation plans and annual reports, and clarification on NERC's proposed management procedures. In order to ensure that all elements of the enforcement process are approved and implemented on the date on which the Commission will permit the ERO and Regional Entities to begin assessing penalties, the Commission directs NERC to provide in its compliance filing a schedule for the completion of each of these programs and a discussion of the activities taken to complete each program.

353. With regard to EEI's request for the elimination of references to the ERO's enforcement of Reliability Standards applicable to a regional reliability organization or a Regional Entity,[144] consistent with our discussion of the compliance registry, the matter of the applicability of a Reliability Standard to a regional reliability organization or a Regional Entity will be addressed in Docket No. RM06-16-000 or other proceedings involving a proposed Reliability Standard.

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[144] In our discussion of governance above, the Commission asks NERC to explain the relationship between the regional reliability organization and a Regional Entity under NERC's proposal.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

354. Section 405 of the Rules of Procedure provides that a NERC stakeholder compliance committee shall establish and implement a process to monitor NERC's compliance with Reliability Standards that apply to NERC. We believe that the stakeholder compliance committee should also monitor NERC's compliance with the Rules of Procedure.

355. We note that Commission staff will also monitor compliance by NERC with any Reliability Standard that applies to it. We also agree with EEI that NERC must identify the Reliability Standards that apply to NERC and explain whether they would include NERC's proposed Rules of Procedure in its compliance filing.

d. Remedial Actions

356. Order No. 672 describes a remedial action as an action the ERO or Regional Entity may take to bring an entity into compliance with a Reliability Standard separate from the action to penalize the entity for its noncompliance.[145] The Commission provided the following examples in Order No. 672 of types of remedial actions: compliance directives; informing an industry chief executive officer of a violation of a Reliability Standard; notifying a relevant regulatory authority of a violation of a Reliability Standard; directing a user, owner or operator to develop and comply with a remediation plan; imposing increased auditing or additional training requirements; and informally notifying an entity, orally or in writing, of a possible violation to request that the entity stop that activity.[146] The ERO or Regional Entity must inform the Commission of any remedial actions pursuant to section 39.7(b).

357. Order No. 672 requires an ERO candidate to specify in its application the types of remedial actions that it proposes to undertake without invoking the 31-day waiting period after notice for a monetary penalty or non-monetary penalty to become effective.[147]

NERC Proposal

358. NERC proposes in its Sanction Guidelines[148] that when the ERO or a Regional Entity identifies a violation of a Reliability Standard, or a situation that poses a

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[145] Order No. 672 at P 475.

[146] *Id.* at P 477.

[147] *Id.* at P 474, 477, 479. The ERO and Regional Entities may clarify the distinction between a remedial action and a non-monetary penalty in the ERO certification application, penalty guidelines or delegation agreement.

[148] Rules of Procedure, app 4.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

significant risk of such a violation, that must be corrected promptly to reduce a reliability threat to the Bulk-Power System, it or the Regional Entity will issue a remedial action directive to resolve the violation. NERC states that remedial actions generally will specify minimum corrective actions. It proposes that either it, as the ERO, or a Regional Entity may issue such directives at any time during the investigation, hearing, or appeal process of an alleged or confirmed violation. NERC lists examples of remedial action directives, which include specifying operating or planning criteria, limits, or limitations; requiring specific system studies; defining operating practices or guidelines; requiring confirmation of data, practices, or procedures through inspection testing or other methods; requiring specific training for personnel; and requiring development of specific operating plans. NERC indicates that the ERO or the Regional Entities will issue a remedial action directive whenever deemed necessary and will include in it a deadline by which the user, owner or operator must demonstrate compliance to the remedial action directive by completing the requirement set out in the directive. Failure or refusal to comply with a remedial action directive may result in further remedial action directives or significantly increased penalties. NERC advises that the lack of issuance of a remedial action directive would not relieve a noncompliant entity of its responsibility to comply with Reliability Standards.

359. NERC states that it will promptly notify the applicable governmental authority of any remedial actions it, as the ERO, or a Regional Entity may issue. However, NERC does not specify how an entity will be notified of a remedial action. NERC also indicates that it, as the ERO, or a Regional Entity may direct a violator – alleged or otherwise – to take remedial action, without regulatory approval. If a user, owner or operator of the Bulk-Power System does not act or cease to act to avert a violation of a Reliability Standard after receiving a compliance directive from a Regional Entity or NERC, NERC may petition the appropriate governmental authority to issue a compliance order.

Comments

360. Allegheny requests that the Commission limit remedial action directives to "real-time" violations. Allegheny opposes use of remedial measures where the violation does not pose an immediate threat to system reliability, has not been confirmed, and is not supported by regulatory approval. Similarly, Bonneville asks that the Commission limit remedial actions to those minimally necessary to remedy an effect on reliability and to bring an entity into compliance. Bonneville argues that the examples of remedial actions NERC provides in section 6.7 of the Sanction Guidelines do not clarify the ERO's remedial authority and have potentially enormous scope.

361. EEI asks whether an entity that is found not to have complied with a Reliability Standard may contest a mitigation plan. PG&E expresses concern that NERC's proposed procedures for remedial actions and compliance directives could violate due process because section 6.5 of the Sanction Guidelines permits remedial actions prior to a finding

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

of a violation, regardless of whether the violation is confirmed. Because such a directive is not itself appealable, the entity receiving such a directive must comply or be subject to an increase in penalties. Review of the compliance directive could be delayed or eliminated if there is no finding of violation, precluding effective review. PG&E proposes adding provisions to the Rules of Procedure and Sanction Guidelines to provide for immediate appeal to the ERO of remedial actions or compliance directives, without delaying compliance with the directive, and to require the issuance of a final investigative report within 12 months of issuance of a remedial action or compliance directive.

362. Bonneville asks that the Commission require that a regional reliability organization have primary responsibility to manage, investigate and report on major system events and off-normal events within its region under sections 807 and 808 of the Rules of Procedure, leaving NERC to assist these efforts and taking a leadership role on significant events such as a major blackout. WECC advocates that Regional Entities, not NERC, lead investigations of system disturbances within their own regions pursuant to NERC's Blackout and Disturbance and Response Procedures.[149]

NERC Reply Comments

363. NERC agrees with commenters who assert that remedial actions generally should be limited to instances in which the ERO or a Regional Entity has identified a violation of a Reliability Standard that must be corrected promptly to reduce a threat to Bulk-Power System reliability or otherwise ensure reliability. NERC asserts that these corrective actions should not be subject to a 31-day period before becoming effective, as is the case with penalty assessments.

Commission Conclusion

364. In Order No. 672, we found that the ERO and each Regional Entity must have authority to take remedial actions to bring entities into compliance with Reliability Standards. The most important purpose of remedial actions is to reduce the risk to Bulk-Power System reliability that would occur if actions that appear to be in violation of Reliability Standards are not corrected. In these circumstances, there could be insufficient time to adjudicate the existence and extent of violations before a threat to reliability would occur or increase as a result of an ongoing practice that would be the subject of a remedial action. Further, subjecting such a remedial action to a 30-day delay, as would be the case if remedial actions were required to be the subject of a notice of penalty filed with the Commission, could prevent effective remedial action needed to reduce reliability threats. We note that, in its reply comments, NERC agrees with

[149] *Id.*, app 8.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

commenters that remedial actions generally should be limited to situations in which a corrective action appears to be needed to address promptly threats to Bulk-Power System reliability.

365. In this context, we continue to agree that the ERO and each Regional Entity must have authority to issue a remedial action directing a user, owner or operator of the Bulk-Power System to come into compliance promptly prior to any final determination of violation. In response to the concerns expressed by Allegheny and Bonneville, we expect that such remedial actions generally would be limited to the minimum corrective actions needed to address violations that pose a significant actual or potential threat to Bulk-Power System reliability. Such corrective actions would be the most likely to be completed in a timely manner to avert reliability threats. Nonetheless, we disagree with Bonneville that NERC's list of possible remedial actions that the ERO or a Regional Entity could take is excessive. We believe that the ERO or a Regional Entity must have the flexibility to tailor particular remedial actions to specific factual circumstances, so long as the options chosen in a particular matter are appropriate.

366. NERC does not indicate how the ERO or a Regional Entity will provide notice of a remedial action to a user, owner or operator of the Bulk-Power System. NERC also does not set forth procedures under which the ERO or a Regional Entity will issue a remedial action. We find that, to provide appropriate notice to entities that may be subject to remedial actions, NERC must set forth procedures for ERO and Regional Entity remedial actions in its compliance filing. In the procedures, NERC must provide that the ERO or Regional Entity will inform an affected entity of each specific Reliability Standard that the entity appears to be violating or may violate in the near future, and the factual basis for the entity to undertake the remedial action. In addition, NERC should consider PG&E's proposal for there to be an expedited appeal where remedial actions are proposed. The procedures also must include effective methods for providing timely notice of remedial actions to affected entities. Aside from ensuring fairness to entities that receive remedial actions, specifying methods for notice will help prevent instances in which needed corrective actions are not performed timely as a result of a communication failure. We believe that NERC must provide for multiple avenues of notice, especially in instances when immediate corrective action is needed. In Order No. 672, we purposefully separated the remedial action process from the penalty process to avoid real-time delays in restoring system reliability caused by continuous non-compliance. The procedures must also contain provisions for notifying the Commission of each remedial action.

367. We observe that if the ERO or a Regional Entity determines that the reliability of the Bulk-Power System could be imminently jeopardized by an entity's noncompliance, the ERO or a Regional Entity may seek immediate, injunctive relief in a court of competent jurisdiction. If an entity fails to comply with a remedial action, or in other

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

appropriate circumstances, the Commission may seek injunctive relief pursuant to section 314 of the FPA.[150] In those situations, we would coordinate with the ERO and applicable Regional Entity.

368. The other objective of a remedial action is to achieve prospective compliance. This process is an integral part of the ERO enforcement program. However, in instances in which prompt correction of apparent or potential violations of Reliability Standards does not appear to be necessary to address threats to Bulk-Power System reliability, we conclude that the ERO and Regional Entities should issue remedial actions in connection with the process for investigating, hearing and adjudicating violations. For example, in the context of an investigation, compliance audit, self-reported violation or any other circumstance in which a potential violation may come to the attention of the ERO or a Regional Entity, NERC or the Regional Entity may informally notify an entity that it appears to be violating a Reliability Standard, request that the entity stop the activity or otherwise take steps to come into compliance.[151] In addition, ERO or Regional Entity compliance staff may address measures for prospective compliance when providing formal notice to an entity that compliance staff believes the entity to be violating a Reliability Standard or likely to violate it in the future.

369. In response to EEI's comment, we concur that in an adjudicatory process relating to violations for which an entity receives a non real-time remedial action that includes a mitigation plan, the entity may seek reconsideration of the mitigation plan.

370. In response to comments by Bonneville and WECC concerning the allocation of responsibility for conducting investigations of system disturbances, major system events and off-normal events, we agree with NERC's proposal that the ERO provide leadership and coordination for investigations of major events such as blackouts, system disturbances, and emergencies. As proposed, sections 807 and 808 of the Rules of Procedure adequately set forth the ERO's role with respect to situations such as off-normal events and major system disturbances. We observe that sections 807 and 808, and the NERC blackout and disturbance response procedures referenced in section 807.5 as appendix 8 to the Rules of Procedure, do not describe the roles of Regional Entities in such matters. Because Regional Entities should have an important role in investigations of system disturbances and other major events that affect their regions, we direct NERC to amend sections 807 and 808 and appendix 8 to set forth the respective roles of Regional Entities, along with regional reliability organizations, in event analysis.

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[150] *See, e.g.*, Order No. 672 at P 546.

[151] *Id.* at P 477.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

3. Investigations of Violations and Alleged Violations and Reporting of Violations to the Commission

371. The ERO and the appropriate Regional Entity will conduct investigations of alleged violations of Reliability Standards.[152] The ERO shall maintain its 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.[153] An entity alleged to have violated a Reliability Standard is entitled to timely notice of the allegation. Section 39.7(b) of the Commission's regulations provides that the ERO 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. However, the Regional Entity shall first report these matters to the ERO, which shall report them to the Commission.

372. In addition, to ensure that each Regional Entity implements the enforcement program in a consistent manner, each Regional Entity is required to file a periodic report with the ERO on its enforcement investigations (*i.e.*, identifying its investigations and their dispositions) in a manner determined by the ERO in its certification application.[154] This report differs from the periodic summary reports on violations required pursuant to section 39.7(b)(5) in that the latter summary report on investigations will specify how a Regional Entity carries out its delegated enforcement authority, rather than identifying the violations themselves.

NERC Proposal

373. NERC states that investigations will be initiated at the discretion of the Regional Entity enforcement program staff, the senior executive officer of the Regional Entity, NERC compliance staff or the NERC president. Although each Regional Entity will have its own enforcement program, NERC will retain ultimate responsibility with regard to how a Regional Entity conducts investigations.

374. Each Regional Entity must report to NERC each violation, whether self-reported, alleged or discovered by the Regional Entity through an audit or investigation. For a violation where the reliability of the Bulk-Power System may be diminished or at risk, the Regional Entity must report to NERC, within 48 hours upon the Regional Entity's learning of the violation, regarding the nature and reliability impact of the alleged violation, the entities involved, and the status and timetable of any investigation. NERC

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[152] *Id.* at P 45.

[153] *Id.* at P 486.

[154] *Id.*

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

will promptly notify the applicable governmental authority of any violation, alleged violation, investigation, enforcement action or compliance directive. Each Regional Entity and NERC will report new information to the Commission on alleged and confirmed violations as the information is received and processed. NERC proposes that reports to governmental authorities on the disposition of a violation will be provided at least quarterly or as otherwise required by NERC.[155]

Comments

375. While section 403.13 of the proposed Rules of Procedure states that NERC is ultimately responsible for how a Regional Entity conducts investigations, EEI contends that NERC does not set forth due process procedures and requirements for conducting an investigation. EEI states that NERC's Rules of Procedure should clearly define when and how an investigation begins, how an entity will learn of it, who in Regional Entity compliance staff and ERO compliance staff will conduct it, and its non-public nature. EEI believes that at the outset of an investigation, the entity alleged to be in violation should receive notice of the scope and nature of the investigation and the entity's due process rights. In EEI's view, NERC's Rules of Procedure should establish what and how data may be collected during an investigation; how an entity may challenge information collection, review the record, or provide evidence for the record; how the record will be maintained; and how a decision to proceed with enforcement is made after an investigation.

376. EEI suggests that alleged violators should have an opportunity to review the allegation to clarify findings, rectify any misinterpretations by a Regional Entity compliance staff or compliance committee, submit additional information or provide a written response to the allegation. EEI urges that Regional Entity compliance staff or a compliance committee should review any additional material or response from the alleged violator and prepare a written draft report, and the alleged violator should have an opportunity to elevate issues for review by the compliance staff or committee before a final notice of violation issues. All notices of violation should be kept confidential during this process, according to EEI, and an entity's due process rights and procedures to appeal a final determination of a violation should be clear.

377. In National Grid's view, NERC does not show how or where it would identify, pursuant to section 408.1.1 of the Rules of Procedure, a matter where reliability may be

[155] Rules of Procedure § 408.1. In section 408.2 of the Rules of Procedure, NERC states that it will report to the applicable governmental authority the disposition of each violation or alleged violation on a quarterly basis.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

diminished or at risk that a Regional Entity should report to NERC within 48 hours of learning of the matter. National Grid suggests that this identification and reporting requirement be incorporated into applicable Reliability Standards.

378. Because section 408.2 of the Rules of Procedure, which requires quarterly reporting by NERC to governmental authorities on dispositions of violations and alleged violations, and section 408.4 of the Rules of Procedure, which could be interpreted as requiring Regional Entities to update NERC immediately about new information on each confirmed or alleged violation, may be inconsistent, National Grid suggests that NERC clarify the reporting frequency for each provision. With respect to the requirement in proposed section 408.4 of the Rules of Procedure that each Regional Entity and NERC report new information on confirmed or alleged violations as it is collected, EEI seeks clarification on who would receive such reports, confidentiality provisions that are applicable to them, and whether an alleged violator has the right to review and respond to this information before it is reported.

Commission Conclusion

379. We find that NERC's application generally sets forth acceptable Rules of Procedure regarding investigations of non-compliance with Reliability Standards and is accepted, except for the specific issues discussed below.

380. NERC's application does not satisfy the requirement set forth in Order No. 672 that the ERO retain the ability to direct a Regional Entity to refer an investigation to the ERO when appropriate. Nor does NERC address how the ERO and Regional Entities will avoid multiple investigations involving the same matters. We direct NERC to address the Order No. 672 requirements on these matters in its compliance filing. We also suggest that NERC revise appendix 8 to its Rules of Procedure to state specifically that, in relation to an investigation of a blackout or other ongoing disturbance, the ERO will consider an enforcement action for any violation it finds. We also note that, pursuant to Order No. 672, the Commission maintains the ability to direct the ERO or a Regional Entity to refer an investigation to the Commission when appropriate.

381. To afford adequate due process to entities whose activities are investigated, NERC shall develop and submit in its compliance filing detailed procedures under which the ERO and Regional Entities will conduct investigations, including how they will obtain relevant information and documents. We will not prescribe particular procedures at this juncture, but we believe that NERC must consider whether particular provisions of the Commission's investigative rules would provide a useful analogy for the rules NERC should use.[156] Further, the ERO and Regional Entities must maintain uniform

[156] 18 C.F.R. Part 1b (2005).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

investigative procedures insofar as possible and must justify any departures from or differences in these procedures as between the ERO and a Regional Entity or as between different Regional Entities.

382. We do not agree with EEI that an entity under investigation must receive at the outset of an investigation a description of the scope and nature of the investigation. For example, the ERO or a Regional Entity may be able to open, resolve and close an investigation into an alleged violation without notifying the alleged violator until the investigation is closed. Further, it is not generally appropriate for an investigator to notify an entity at the outset of an investigation of each potential violation or issue that an investigation will address. Such a notice requirement could adversely affect the efficiency of investigations by enabling potential violators to hide or destroy relevant information. Moreover, the investigator may not know the precise scope of the investigation until all relevant facts are obtained and considered. However, it is appropriate at some point in the investigation for the ERO or Regional Entity staff to notify an entity whether the staff would be prepared to seek a determination that a violation has been or is being committed and any appropriate penalty or remedy that, in staff's view, would be appropriate, and provide an opportunity for the entity to respond and present its position on the matter. NERC must include such a process in its compliance filing to also encourage settlements and resolutions of investigations that do not require formal adjudicatory procedures.

383. NERC proposes to promptly notify the applicable governmental authority of any violation, alleged violation, investigation, enforcement action or compliance directive.[157] The Commission intends this notification provision as a mechanism to provide it with prompt, limited information to enable the Commission to understand the general nature of a violation or an alleged violation that occurred or is occurring within the United States and to identify a contact person who can furnish its status to the Commission.[158] NERC's list of events that would trigger a notification of the applicable governmental authority omits self-reported violations. We direct NERC to add those matters to the list as part of its compliance filing. Additionally, a requirement, proposed by NERC, that a Regional Entity report within 48 hours to the ERO of a violation of a Reliability Standard that may put the Bulk-Power System at risk and that NERC would promptly notify the Commission does include any time limit that would apply to NERC's notification to the Commission. We direct NERC to provide such notification promptly, as required in section 39.7 our regulations, for any self-reported violation or investigation of a violation

[157] Rules of Procedure § 408, 408.1.

[158] 18 C.F.R. § 39.7(b) (2005). Order No. 672 at P 49.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

or alleged violation of a Reliability Standard. Because we do not believe it is possible for the ERO or a Regional Entity to describe all instances in which the 48-hour report would apply, we decline National Grid's request for greater specificity about such instances.

384. We reject National Grid's request that NERC clarify or harmonize the reporting requirements established in sections 408.2 and 408.4 of the Rules of Procedure. It is sufficiently clear that NERC will report investigation dispositions on a quarterly basis (section 408.2) and report new information relating to an ongoing investigation "as it is received and processed." As EEI suggests, NERC should identify who would receive such reports and describe the confidentiality provisions that are applicable to them in its compliance filing. Nevertheless, because these reports are intended to serve as a non-public mechanism for Regional Entities to report to NERC, and for NERC to convey to the Commission staff, information on the status and disposition of particular investigations, we do not agree that an alleged violator has the right to review and respond to this information before it is reported.

4. Confidentiality of Investigations and Reports

385. This section of the order addresses NERC's proposed confidential treatment of information pertaining to enforcement-related investigation and reports. NERC's proposed treatment of confidentiality in general is addressed below in the Reliability, Adequacy, and Other Information section of this order.

386. Section 39.7(b)(4) provides that 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.

387. An ERO candidate must submit ERO Rules with its 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.[159]

NERC Proposal

388. NERC intends that all investigations will be non-public unless NERC or the Regional Entity determines a need to conduct a public investigation. Advance authorization from the appropriate governmental authority would be required for all

[159] Order No. 672 at P 534.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

public investigations or enforcement audits. Before information relating to an investigation or audit is disclosed to the public, the ERO or a Regional Entity must give users, owners and operators of the Bulk-Power System that assert that they provided confidential information concerning a violation a reasonable opportunity to demonstrate that such information is confidential and must not be disclosed.

389. NERC proposes to maintain the confidentiality of information shared in the ERO's enforcement program. The ERO and the Regional Entities must have in place appropriate codes of conduct for compliance staff and confidentiality agreements that other enforcement program participants must execute before participating. A violation of the code of conduct or a confidentiality agreement will result in sanctions of the subject staff or participant by the ERO or a Regional Entity, including prohibiting participation in future enforcement activities.

390. In section 408.3 of its Rules of Procedure, NERC proposes specific terms and conditions governing the types of information that will be considered confidential and will not be disclosed in public information reported by NERC.[160] In addition, section 408.3 requires an entity seeking to protect information as confidential to demonstrate that the information qualifies for confidential treatment. NERC cites section 408 of the Rules of Procedure throughout the application as the controlling section for confidentiality issues and reporting information.

Comments

391. Ameren seeks clarification that the procedures to designate confidential information apply to investigations, audits and enforcement actions. Ameren and EEI contend that NERC's Rules should clearly identify the information to be maintained as confidential, list the phases in the enforcement program in which the information would remain confidential, and set forth the process for asserting and maintaining confidentiality without inconsistencies. As an example of such inconsistency, EEI cites sections 202.17 and 402.5 of the Rules of Procedure, which would require disclosure of "confirmed" violations, while other provisions, such as section 408.1, would require NERC to provide information about alleged violations to the applicable governmental authority. Contending that NERC's application focuses primarily on protecting critical energy infrastructure information (CEII) from public disclosure, Georgia Operators,

[160] NERC lists the following types of specific information as confidential, subject to applicable statutory and regulatory requirements: (1) confidential business and market information including information that is proprietary, commercially valuable, or competitively sensitive; (2) critical energy infrastructure information; (3) personnel information; (4) audit work papers; or (5) investigative files.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Ameren and TAPS assert that NERC should more completely describe other information that should remain confidential and specifically provide that such other information not be released publicly.

392. TAPS asserts that section 408.6 of the Rules of Procedure, which provides for public posting of, among other things, investigation reports, provides for the redaction of information that a user, owner or operator of the Bulk-Power System, a Regional Entity or NERC deems to be CEII, as defined in a NERC publication, but does not provide for redaction of other confidential information. TAPS suggests that NERC's proposed Rules may permit the ERO and Regional Entities to disclose publicly non-CEII confidential information in their postings.

393. Asserting that nothing in the proposed Rules of Procedure or the *pro forma* delegation agreement requires Regional Entities to conduct nonpublic investigations, National Grid asks that NERC revise the *pro forma* delegation agreement to require explicitly that Regional Entity enforcement programs adopt procedures to preserve confidentiality during investigations. Ameren requests that until an investigation or audit is closed and appeal rights have been exhausted or expired, public disclosure of information gathered should not be permitted. Ameren argues that at that point all non-confidential portions of the record should be made public, and that such disclosure will encourage other entities to conform to the Reliability Standards.

394. To prevent the unwarranted public disclosure of sensitive information relating to an investigation, National Grid contends that the Commission should direct NERC to limit NERC’s notification of governmental authorities about alleged violations, investigations, enforcement actions and compliance directives to the Commission and other governmental authorities that commit to preserve that information as confidential. National Grid further asks that NERC revise its proposal relating to the public posting of audit reports to require the redaction of information about unconfirmed violations, in addition to requiring redaction of business sensitive energy information or CEII prior to the posting of any audit report.

395. TAPS requests NERC to revise its Rules of Procedure to clarify that any settlement of a possible violation should be publicly reported, regardless of whether a violation has been alleged or an investigation has resulted in a finding or allegation of violation, and to amend Rules of Procedure that would require disclosure of only a subset of settlements, such as proposed sections 202.17, 402.5, and 408.6 of the Rules of Procedure.

NERC Reply Comments

396. In its answer, NERC states that it agrees with the commenters who state that compliance investigations and proceedings should be non-public until such time as NERC reports a confirmed violation to the Commission. NERC asserts that its proposed

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Rules of Procedure specify that it shall disclose confirmed violations and shall maintain as confidential alleged violations. The Rules of Procedure also specify that confirmed violations, monetary penalties and non-monetary penalties shall be posted on NERC's website when the affected user, owner or operator of the Bulk-Power System agrees with the violation, the time for submitting an appeal has passed, or all appeal procedures are completed. Finally, NERC states that it agrees that it and the Regional Entities must develop and maintain the record for each compliance proceeding, and that these records would be filed with the Commission at the time NERC files a notice that it has confirmed a violation and imposed a penalty.

Commission Conclusion

397. While the description of information that NERC proposes that the ERO and Regional Entities protect from public disclosure appears in the enforcement provisions of NERC's Rules of Procedure, NERC applies that description in a number of provisions throughout the Rules of Procedures. We take this opportunity to discuss two general enforcement-related issues relating to claims that particular information that the ERO or a Regional Entity receives must be treated as confidential or otherwise exempt from public disclosure.

398. NERC does not specifically reference processes for identifying and protecting from public disclosure information concerning violations or alleged violations relating to a Cybersecurity Incident or any disclosure that would jeopardize Bulk-Power System reliability. Section 39.7(b)(4) of our regulations requires that such information be exempt from public disclosure unless the Commission directs otherwise. While NERC describes several types of information that must be treated as confidential, it is not clear whether information related to a Cybersecurity Incident would, in all instances, be protected as critical energy infrastructure information, as set out in section 408.3.2 of the Rules of Procedure. Order No. 672 emphasized the need to protect such types of information. Accordingly, we direct NERC to revise section 408.3.2 to explicitly require that information that would jeopardize Bulk-Power System reliability, including information relating to a Cybersecurity Incident, be identified and protected from public disclosure.

399. Nor does NERC define the categories of information, such as "confidential business and market information including information that is proprietary, commercially valuable or competitively sensitive," that it proposes that the ERO and Regional Entities treat as confidential. We recognize the need for protection from public disclosure of confidential commercial information, for example, because we withhold such information from public disclosure when warranted in response to requests pursuant to the Freedom of Information Act. However, NERC's categorization of particular types of information as confidential or otherwise exempt from public disclosure may be too broad, given, in particular, the public interest in disclosure of facts relevant to violations of Reliability Standards.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

400. Therefore, consistent with concerns of Georgia Operators, Ameren and TAPS, we direct NERC to explain in its compliance filing how the ERO and Regional Entities would define specific types of information that must be treated confidentially or as otherwise exempt from public disclosure. We believe that the ERO and the Regional Entities must apply the same standards in all provisions of the Rules of Procedure concerning confidentiality of information. Until we receive NERC's explanation, we defer our consideration of comments that we require the ERO and Regional Entities to protect from public disclosure categories of information that NERC did not specifically list in proposed section 408.3 of the Rules of Procedure, such as "business sensitive energy information," "commercially sensitive information," and information that an entity would be prohibited from sharing with an affiliate pursuant to Codes of Conduct approved by the Commission.

401. We now turn to issues raised by NERC's application with respect to investigations and audits undertaken by the ERO or Regional Entities. Although NERC proposes that its and Regional Entities' investigations and compliance audits will be non-public unless NERC or the Regional Entity determines a need to conduct a public investigation, NERC recognizes that advance authorization from the applicable governmental authority will be needed for a public investigation. We interpret NERC's application as recognizing that the Commission is the "applicable governmental authority" in the United States. As so construed, we believe that NERC's application is consistent with the Order No. 672 requirements concerning the nonpublic nature of ERO and Regional Entity investigations and compliance audits. We do not express any opinion on whether other appropriate government authorities should authorize public investigations of possible violations falling within their jurisdiction. However, we believe that it is important for the Commission to coordinate the authorization of public investigations with other applicable governmental authorities as appropriate.

402. We believe that it can be fairly gleaned from section 408.1 of NERC's Rules of Procedure that the procedures to designate confidential information set forth in section 408.3 apply to investigations, audits and enforcement actions. Nonetheless, to ensure that there is no future uncertainty, we direct NERC to state this explicitly, as requested by Ameren. Regarding National Grid's and Ameren's concerns on the need to maintain confidentiality during a compliance investigation, we note that the Rules of Procedure and the pro forma delegation agreement provide that NERC and the Regional Entities will treat a violation or alleged violation as nonpublic until the matter is filed with the Commission as a notice of penalty or resolved by an admission, settlement or other negotiated disposition.[161] We find that this language is adequate.

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[161] *See* Rules of Procedure § 402.5 and 402.9; *Pro forma* Regional Delegation Agreement § 6(c).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

403. We reject EEI's claim that there is an inconsistency between provisions of NERC's proposed Rules that require public disclosure of confirmed violations and NERC's reports on investigations to the Commission. NERC's proposal is in response to section 39.7(a) of the Commission's regulations, which requires the ERO and each Regional Entity to have procedures to report promptly to any violation or alleged violation to the Commission. Consistent with section 39.7(b)(4) of our regulations, the ERO, Regional Entities and the Commission will treat violations and alleged violations as nonpublic until the matter is filed with the Commission as a notice of penalty, the matter is otherwise resolved, or the Commission determines that the ERO or Regional Entity should conduct a public investigation.[162] The ERO's reports to the Commission on violations and alleged violations will remain nonpublic unless otherwise directed by the Commission. At this time, we decline to adopt National Grid's suggestion that the ERO should limit its notifications about alleged violations, investigations, enforcement actions and compliance directives to the Commission and other governmental entities that commit to preserve such reports as confidential. We believe that such issues will be better addressed in the context of specific requests by other governmental entities for information NERC reports to us.

404. We agree with TAPS that any settlement of a potential violation to which a Regional Entity or the ERO is a party must be made public, whether or not a violation has been alleged or a finding of violation has occurred. Section 39.7(b)(4) so provides (subject to a overriding prohibition against public disclosure of a violation or alleged violation that relates to a Cybersecurity Incident or that would jeopardize Bulk-Power System reliability if publicly disclosed, unless the Commission otherwise directs). We disagree with TAPS that the proposed ERO Rules of Procedure are inconsistent with section 39.7(b)(4). To the contrary, proposed section 403.18 states that the ERO shall publicly post each violation settled, whether confirmed or not, and the resulting penalty or sanction. On a related point, we do not believe that it is necessary for the Commission to prohibit public disclosure of information relating to an audit or investigation until an investigation or audit is closed and appeal rights have been exhausted or expired, as Ameren suggests. One situation in which partial public disclosure of information appears to be appropriate is when a subset of possible violations at issue in an investigation or audit is settled or adjudicated, while other issues remain unresolved or subject to appeal. In at least that circumstance, we believe that the ERO or a Regional Entity may disclose publicly the settled or adjudicated violations, subject to advance Commission approval, while maintaining as non-public the remainder of the investigative or audit record.

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[162] Order No. 672 at P 534.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

5. Penalties, Due Process, and Appeals

405. The fundamental goal of mandatory, enforceable Reliability Standards and related enforcement programs is to promote behavior that supports and improves Bulk-Power System reliability. Effective enforcement of mandatory Reliability Standards includes the ability of the ERO to implement the enforcement provisions of the Commission's regulations and impose penalties, subject to Commission review, for violations of Reliability Standards.[163]

406. With respect to the assessment of penalties for a violation of a Reliability Standard, the ERO or a Regional Entity may assess a penalty subject to Commission review.[164] Sections 39.7(c) and (d) of our regulations provide that the ERO or a Regional Entity may impose, subject to section 215(e) of the FPA, 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 ERO or the Regional Entity finds that the user, owner or operator has violated the Reliability Standard; and (2) the ERO 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 ERO shall serve a copy of the notice of penalty on the entity that is the subject of the penalty.

a. Penalties

407. Section 39.7(g)(2) requires the ERO to develop and submit to the Commission for approval penalty guidelines that identify a range of non-monetary and monetary penalties that the ERO or a Regional Entity will apply for determining the appropriate penalty for the violation of a Reliability Standard. 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. Any penalty imposed by the ERO or a Regional Entity must be within the range set forth in the penalty guidelines. The ERO may consider, among other things, the relative size of an entity or its financial ability as a factor in determining an appropriate penalty.

NERC Proposal

408. NERC states that it and each Regional Entity will apply penalties and remedial actions, as set forth in the ERO Sanction Guidelines, which NERC asserts bear a reasonable relation to the seriousness of a violation and take into consideration timely

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[163] *Id.* at P 505, 517.

[164] *Id.*

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

remedial efforts.[165] The proposed ERO Sanction Guidelines recommend ranges for monetary penalties, taking into consideration aggravating, mitigating, or extenuating factors, and do not prescribe fixed penalties for particular violations. Rather, the Guidelines list adjustment factors to afford the ERO or Regional Entity needed flexibility to accommodate the facts concerning each violation.

409. NERC provides that the ERO or a Regional Entity will have discretion to impose monetary penalties, non-monetary penalties, or remedial actions with respect to a particular violation. Both the ERO and Regional Entities will follow the ERO Sanction Guidelines when assessing monetary and non-monetary penalties and ordering remedial actions. NERC will oversee the Regional Entities' application of the Guidelines to ensure that they achieve acceptable levels of consistency.

410. Specifically, to levy a monetary penalty under the Sanction Guidelines, the ERO or a Regional Entity would initially establish a Base Penalty Amount for a particular violation by considering the violation's risk factor, based on an assessment of the violation's impact on reliability, and the violation's severity level, assigned as a measurement of the degree to which the relevant Reliability Standard was violated. The ERO or Regional Entity would adjust the Base Penalty Amount to reflect the violator's size and the time horizon of the violation. The highest Base Penalty Amount is $200,000; the lowest Base Penalty Amount is $1,000. NERC does not state whether a Base Penalty Amount is established on a per-day, per-violation or per-occurrence basis.

411. The ERO or a Regional Entity could adjust the Base Penalty Amount by considering aggravating or mitigating Final Adjustment Factors. These factors would include: the violator's compliance history; failure of the violator to adhere to compliance directives; self-disclosure of the violation and voluntary corrective action by the violator; the violator's cooperation with the investigation; the violator's compliance program; any attempt by the violator to conceal the violation; intentional violations; extenuating circumstances; and egregious conduct. The ERO Sanction Guidelines states that it sets forth many "facets" of these factors, but also states that the ERO or a Regional Entity may consider other facets of these factors or factors not listed in the Sanction Guidelines, so long as they are identified and their use is justified.[166] NERC asserts that the adjustment factors established in the ERO Sanction Guidelines are generally consistent with those listed in the Commission's Policy Statement on Enforcement.[167]

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[165] Rules of Procedure § 401.7. In its application, NERC generally refers to non-monetary penalties, as discussed in Order No. 672, as "sanctions."

[166] Rules of Procedure, app. 4, § 3.9.

[167] *Id*. NERC lists the Policy Statement on Enforcement and Release No. 44969 by the Securities and Exchange Commission, issued on October 23, 2001, as instructive

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

412. The Sanction Guidelines identify the maximum monetary penalty that could be imposed in the United States as the maximum civil penalty under the FPA of $1,000,000 per day per violation. To assess the maximum allowable monetary penalty, the ERO or a Regional Entity would have to adjust a Base Penalty Amount upward after determining, as an aggravating factor, that a particular violator's conduct was "egregious."

413. NERC states that it or a Regional Entity may impose a non-monetary sanction in lieu of or in addition to a monetary penalty. As examples of non-monetary penalties, NERC refers to limitations on a violator's activities, functions and operations; placement of an entity on a reliability watchlist composed of major violators; and notifications of boards of directors, regulators and others. NERC proposes that when assessing a non-monetary penalty, the ERO or a Regional Entity should disclose the monetary value that such a penalty represents to the violator. NERC intends that the ERO or a Regional Entity thereby "monetize" the value of a non-monetary penalty to compare monetary penalties or non-monetary penalties that might be imposed for a particular violation.

414. NERC proposes to apply its Sanction Guidelines during 2006, without collecting penalties, and to identify any improvements necessary prior to applying penalties. NERC intends to file with the Commission in October 2006 any revisions to the Sanction Guidelines that result from this experience. NERC asks that the Commission approve the revised Sanction Guidelines for use for a six-month "notice period," during which NERC intends to determine "financial" penalties and provide notice of the penalties to violating entities, but would not collect any penalties. NERC asserts that the notice period would provide an opportunity for a formal test of the Sanction Guidelines. NERC would submit a report on the effectiveness of the revised Sanction Guidelines to the Commission by May 31, 2007.

415. NERC proposes that any revision to the ERO Sanction Guidelines, or any principle or factor identified or addressed in it must be approved by the NERC board, then by the Commission, or appropriate authorities in Canada or Mexico, prior to becoming effective and applicable in the United States or the other authorities' respective jurisdictions.

Comments

416. ISO/RTO Council contends that it would be premature for the Commission to accept NERC's proposed penalty matrix because NERC is field-testing it and may file revisions in October 2006 and because the full import of the matrix cannot be evaluated until the Commission completes review of the proposed Reliability Standards.

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to the ERO and Regional Entities when determining penalties. *Id.* § 4.3.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

417. California Commission requests NERC to clarify that the penalty amounts in the Sanction Guidelines' Base Penalty Amount Table are per-day penalty amounts. While agreeing with the principle that penalty determinations use a Base Penalty Amount that is adjusted for various factors, Bonneville requests that the Commission require NERC to clarify the factors to be considered in levying penalties and specify how each factor affects the penalty amount. In this respect, Bonneville finds NERC's application unnecessarily subjective, complex, vague, and unworkable. While agreeing with use of a penalty matrix to determine penalties for violations, Ameren finds that NERC's penalty matrix allows for a considerable degree of discretion. California Commission is concerned that penalty adjustment factors could permit the unlimited adjustment of penalties. Based on its experience administering penalties through its voluntary Reliability Management System, WECC believes that the penalty for a violation, though based on a determination of facts, should be objective and not a matter of judgment or discretion.

418. Bonneville encourages deletion of some penalty adjustment factors. ISO/RTO Council urges the Commission to require that NERC amend the Sanction Guidelines to include factors such as organizational structure and not-for-profit status. NRECA urges the Commission to require that the ERO and a Regional Entity consider an entity's ability to pay when assessing penalties to ensure consistency and fairness.

419. To satisfy due process requirements concerning notice of factors used to determine penalties, Bonneville recommends that the Commission disapprove section 3.9 of the Sanction Guidelines, which permits the ERO and Regional Entities to consider additional, unidentified factors in penalty assessments. Bonneville would require the ERO to consider only those factors specifically identified in its Sanction Guidelines to avoid rendering the factors meaningless.

420. Pointing out that section 3.5 of the Sanction Guidelines could permit the determination of a penalty before a violation has been confirmed, Northern Indiana objects to the imposition of a penalty, particularly a monetary penalty, before a violation is confirmed. If this is not the intent of section 3.5, Northern Indiana requests that it be rephrased. With regard to section 3.6 of the Guidelines, which indicates that the entity that determines a penalty for a violation generally also reviews whether a violation occurred, Northern Indiana seeks clarification on what entity would determine a penalty if it were not the entity reviewing whether a violation occurred.

421. EEI states that the record in a penalty determination must include a written statement of how the ERO or a Regional Entity applied the Sanction Guidelines penalty factors upon which the ERO or the Commission can determine whether the Guidelines were applied in an appropriate, consistent manner. According to EEI, an entity facing imposition of a penalty should be able to present additional evidence with respect to mitigating and other factors in the Guidelines.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

422. To encourage self-reporting of violations, WECC proposes that no penalty be imposed for a self-disclosed first violation, except for severe violations. MRO proposes that NERC adopt a process to expunge an entity's record of compliance violations after a certain time period, perhaps three years, to preclude violations from serving indefinitely as an aggravating factor in future penalty assessments and to act as an incentive to increase compliance.

423. In cases of multiple violations, Bonneville states that the sanction should always be at least as large as the sanction that could be imposed for the most serious violation and that under no circumstances should a penalty for violating a set of standards be less than the penalty for violating a single standard in the set.

424. Observing that the Sanction Guidelines do not explicitly address multi-party violations of Reliability Standards or provide a methodology for penalty allocation in that situation, International Transmission suggests that each party be treated as a violator, with penalties set to reflect an allocation of responsibility for the violation.

425. Bonneville finds unclear how the ERO will determine in assessing penalties that a violator made an "economic choice" to violate a standard because in Sanction Guideline section 3.16, NERC intends to consider this principle even if the violator lost money due to the violation. Bonneville believes that NERC need not separately consider this principle because a "final adjustment factor" described in section 3.14 that increases a penalty for an intentional violation already covers the principle. Bonneville believes that NERC's use of a final adjustment factor to permit imposition of its maximum penalty authority upon a finding of "egregious conduct" is vague and unworkable, and should be deleted.

426. NRECA strongly concurs with statements in NERC's Sanction Guidelines that violator size is a penalty factor and that NERC intends to ensure that a penalty is neither overly burdensome nor inconsequential to an entity by virtue of its size. While generally agreeing that penalty amounts should bear some relation to "violator size," Allegheny requests that the Commission require that NERC justify its approach to determining violator size. Specifically, Allegheny asks NERC to explain why it considers an entity's aggregate size if it operates as more than one type of functional entity, such as a transmission owner and a generation owner, is affiliated with another functional entity, or is located in the footprint of more than one Regional Entity.

427. In contrast, Bonneville, PG&E and National Grid oppose the "violator size" adjustment to the Base Penalty Amount. In PG&E's view, considering size as a measure of the risk or effect of the violation upon Bulk-Power System reliability is unfair and duplicative because: (1) the "violation risk factor" that informs part of the base penalty amount separately addresses that issue; and (2) the reliability risk of any violation should

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

be determined on a case-by-case basis. National Grid views consideration of violator size with reference to the underlying facts of the violation as arbitrary, while the size adjustment factor itself is vague.

428. Because NERC provides that some generation and transmission cooperatives or joint-action agencies can register on behalf of their members by "accepting the reliability functions" of their members, Georgia Operators is concerned that NERC may hold such a cooperative or joint-action agency directly liable for any single member's violation of an applicable standard and may calculate any penalty based on the aggregate size of all members' loads, rather than the violator's load alone, under the Sanction Guidelines. Georgia Operators believes that this result would be unfair.

429. To ensure consistency in assessment of penalties, Allegheny asks that the Commission require NERC to state the criteria or process to be used in determining the "time horizon" for Reliability Standards. Allegheny believes that NERC should specify as part of each proposed Reliability Standard the "time horizon" for that Reliability Standard to be used in levying penalties. Bonneville requests the consolidation of sections addressing violator size and violation time horizon in determining penalties, specifically sections 3.11, 3.12, and 4.2 of NERC's Sanction Guidelines, so that the Rules are clear.

430. Bonneville and NRECA support NERC's proposal for at least a six-month transition period, during which violations are identified, but no penalties are imposed. Bonneville further recommends that NERC's Operating Committee and Planning Committee review the Sanction Guidelines, that their recommendations be incorporated in the report, and that the Commission and Canadian authorities revise the proposed July 1, 2007 start date for penalties, if appropriate. ISO/RTO Council and WECC suggest a one-year transition period. Asserting that there is no need to require enforceable standards effective January 1, 2007, Alcoa asks that the Commission adjust NERC's proposed timetable to prevent on-the-fly development and implementation of standards and enforcement processes.

431. Bonneville asserts that, in NERC's application, the ERO is given unlimited discretion to interfere with any entity's business operations subject to its jurisdiction through imposing non-monetary penalties, and asks the Commission to limit these non-monetary penalties to those minimally necessary to remedy the effect on reliability or to bring an entity into compliance. National Grid observes that while Sanction Guidelines section 3.19 states that the ERO does not prefer monetary penalties over non-monetary penalties, NERC sets forth detailed information about how it would calculate monetary penalties but offers no information on how it would "monetize" non-monetary penalties to help assure consistency between the two types of penalties. National Grid argues that NERC should revise the Sanction Guidelines to state when and what types of non-

monetary penalties are appropriate, and clarify that in circumstances such as minor infractions or violations by non-profit entities that would pass along monetary penalties to others, non-monetary penalties may be preferable to monetary penalties.

432. Bonneville asks the Commission to disapprove Sanction Guidelines section 5, which authorizes the ERO to place major violators on a reliability watchlist as an example of a non-monetary penalty, until NERC clarifies the watchlist's purpose and effect on future penalties of an entity's placement on it.

433. Allegheny urges vigorous oversight by NERC of Regional Entities' enforcement activities by requiring NERC to review all penalties, not just those meeting a monetary threshold or involving certain mitigating or aggravating factors. Ameren seeks clarification as to how NERC will ensure consistency in the application of penalties and sanctions by multiple Regional Entities and requests that NERC develop an internal process, incorporated into its Rules of Procedure, to compile and periodically review enforcement data for consistency and reasonableness across regions and over time.

NERC Reply Comments

434. NERC agrees with commenters that penalties for non-compliance must be applied consistently across all Regional Entity programs and asserts that its Sanction Guidelines should aid in consistency.

435. In regard to comments about whether an entity's size should be considered in imposing a penalty, NERC states that it is in the process of developing "size factors" to be taken into account in determining the amount of a penalty to be assessed. The size factors will be based on a number of considerations, including the entity's generator size, plant size, and kV-miles of transmission line. NERC asserts that the size factors will generally recognize the contribution of the organization's size to the seriousness of the risk of its violation to reliability.

436. NERC does not believe that penalties should be defined through a fixed look-up table from which deviations will not be permitted. It believes that a more flexible approach than suggested by some commenters is necessary for the proper administration of a penalty program in order to deal with the wide variety of circumstances that undoubtedly will be presented. NERC states that its Sanction Guidelines should provide sufficient notice as to the scope of potential penalties.

Commission Conclusion

437. As discussed below, we generally approve NERC's proposed Sanction Guidelines with respect to penalties, but we direct NERC to change or provide additional explanations with respect to a number of specific aspects of its penalty proposal in light of comments and our concerns. Among other things, we require that NERC: include the

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

$1 million per violation, per day maximum penalty amount in the Base Penalty Amount Table; explain how the penalty amounts listed in that table are higher than an economic choice that an entity would make to engage in a violation or a cost of doing business; and explain what consideration of "violator size" and "egregious conduct" in the penalty process is intended to address.

438. In Order No. 672, we determined that penalty guidelines should provide a predictable, uniform and rational approach to the imposition of penalties by the ERO and Regional Entities and help ensure that a penalty meets the requirements of section 215(e)(6) of the FPA.[168] We also stated that 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.[169] We use these touchstones to consider NERC's proposed penalty guidelines and responsive comments.

439. Congress specified that any penalty imposed by the ERO "shall bear a reasonable relation to the seriousness of the violation and shall take into consideration the efforts of such user, owner, or operator to remedy the violation in a timely manner."[170] The Sanction Guidelines seek to meet this standard by providing that for a specific penalty, the ERO and Regional Entities will first calculate a Base Penalty Amount using factors that would apply to each penalty determination. The ERO and Regional Entities then would apply Final Adjustment Factors to adjust the Base Penalty Amount to the particular circumstances of a specific violation. These adjustment factors generally relate to the existence and nature of aggravating or mitigating circumstances that would apply to a particular violation. In discussing the penalty guidelines, we first focus on the calculation of the Base Penalty Amount, then analyze the Final Adjustment Factors and the overall penalty determination.

i. Base Penalty Amount

440. The calculation of the Base Penalty Amount is based, first, on a determination of the "reliability risk factor" NERC will establish for a Reliability Standard that was violated. NERC explains that the risk factors will be grouped in Low, Medium and High categories based on the expected or potential impact of the violation of a particular Reliability Standard to Bulk-Power System reliability. A second determination used in the calculation is the "violation severity level," which NERC characterizes as a measurement of the degree to which a Reliability Standard was violated. The Base

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[168] Order No. 672 at P 561.

[169] *Id.* at P 455.

[170] 16 U.S.C. § 824o(e)(6) (2000).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Penalty Amount Table in the Sanction Guidelines establishes a standard penalty for various combinations of violation risk factor categories and violation severity levels. To determine the Base Penalty Amount, the ERO or a Regional Entity may then adjust the standard penalty upward or downward within a range specified in the Base Penalty Amount Table to account for the relative size of the violator and the time horizon of the Reliability Standard that was violated.

441. We find that the "reliability risk factor" and the "violation severity level" concepts are consistent with the statutory requirement that the "seriousness of the violation" be considered in a penalty determination.

442. NERC explains that the ERO or a Regional Entity will consider adjusting the standard penalty to reflect the violator's size, based on an attribute of size, or a combination of such attributes appropriate for the nature of the standard, the violator and the violation. NERC offers two rationales for considering a violator's size: to ensure (1) that a violator is penalized or sanctioned commensurate with the risk or effect of the violation upon Bulk-Power System reliability as a consequence of the violator's size and "respective reliability exposure" to the Bulk-Power System, and (2) that no penalty levied is overly burdensome or inconsequential to the violator by virtue of its size.[171]

443. While Order No. 672 recognizes that the relative size of an entity may be considered when developing penalty guidelines,[172] the Commission is troubled by NERC's proposed application of this factor. It is not clear why NERC's first rationale, the risk or effect upon Bulk-Power System reliability as a consequence of the violator's size, would not be considered in the violation risk factor or violation severity level. Likewise, as pointed out by commenters, NERC does not explain the meaning of a violator's "respective reliability exposure," how it can be quantified, or how this concept differs from the violation risk factor. Nor does NERC indicate how a violator's size would make a particular penalty amount overly burdensome or inconsequential. At first glance, the relative burdensomeness of a penalty amount would seem to be less directly related to a violator's size than to the violator's ability to pay the penalty – a factor we also authorized the ERO and Regional Entities to consider in penalty determinations in Order No. 672. Accordingly, we direct that, in its compliance filing, NERC either explain what the consideration of size is supposed to address or eliminate it as a factor in the penalty guidelines. Further, NERC must either include "financial ability" as a factor in the penalty guidelines or explain why it believes that such a factor is unnecessary.

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[171] Rules of Procedure, app.4, § 3.11.

[172] Order No. 672 at P 564.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

444. In its compliance filing, NERC must also address Allegheny's concerns about determining the "aggregate" size of an entity that, for example, operates both as a transmission owner and a generation owner. With regard to Georgia Operators' comments, we find that size must be attributed to a particular violator, rather than to a cooperative or joint-action agency to which the violator may belong. However, in light of the penalty amounts shown in the Base Penalty Amount Table, we do not share Entergy's concern that variations in violator size could result in drastic changes in Base Penalty Amounts. The maximum upward adjustment from the standard penalty for both violator size and time horizon is 100 percent, and the maximum downward adjustment is less than 100 percent. These adjustments appear to be much smaller in proportion to the size variation that we would expect between the "largest" and "smallest" users, owners and operators of the Bulk-Power System.

445. NERC justifies its consideration of a Reliability Standard's time horizon as a possible adjustment to the standard penalty in calculating the Base Penalty Amount because, generally speaking, a Reliability Standard with a longer time horizon, such as a standard relating to long-term planning, may have a lesser immediate impact upon, or pose less immediate risk to reliability, or may be more amenable to a remedy, than a Reliability Standard with a shorter time frame, such as a Reliability Standard that applies to real-time operation of the Bulk-Power System.[173] We agree with Allegheny that NERC must state the criteria it will use to determine the time horizon of a particular Reliability Standard so as to ensure consistency in determining Base Penalty Amounts. Moreover, in its compliance filing, NERC must also explain how its rationale for considering time horizon differs from the violation risk factor NERC proposes for developing the standard penalty. NERC need not specify in the process for developing Reliability Standards the time horizon that would apply to each standard, as suggested by Allegheny, because that specification could add additional time to the standard development process.

446. We consider the Base Penalty Amount to represent the penalty that the ERO or a Regional Entity would impose for a particular violation in the absence of any mitigating or aggravating circumstances. In Order No. 672, we required an ERO applicant to show why its penalty determinations would not lead a violator to consider the imposition of a penalty as simply an economic choice or a cost of doing business. NERC does not offer any specific justification that the standard penalty amounts, or the upward or downward adjustments to the standard penalty amounts relating to violator size or time horizon,

[173] *Id.* § 3.12.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

listed in the Base Penalty Amount Table meet the criterion.[174] We direct that, in making particular penalty determinations, the ERO and each Regional Entity justify the penalty amount it imposes with reference to this criterion.

447. We are concerned that the maximum Base Penalty Amount listed in the Base Penalty Amount Table is $200,000. As explained by NERC, this Base Penalty Amount would apply to a violation that had a High violation risk factor, meaning that the violation "has or had the potential to directly cause or contribute to Bulk-Power System instability, separation or a cascading sequence of failures; or did or could have placed the Bulk-Power System at an unacceptable risk of instability, separation or cascading failures."[175] The violation also would have had a severe violation severity level. To reach the $200,000 Base Penalty Amount, the ERO or Regional Entity would have to increase the standard penalty of $100,000 that applies to this combination of risk factor and severity level, based on violator size or the violation's time horizon. NERC presents no rationale why a violator would not consider a $200,000 penalty in those circumstances to be an economic choice or a cost of doing business for behavior that violates a Reliability Standard. We believe that the Base Penalty Amount Table must include the maximum monetary penalty of $1,000,000 per violation per day for such a violation. We direct NERC to modify the table accordingly in its compliance filing. We also direct NERC to justify generally why the other penalty amounts set forth in the Base Penalty Amount Table meet the "economic choice" principle.

448. The Commission agrees with California Commission's request that NERC clarify that the penalty amounts in the Base Penalty Amount Table are per-day penalty amounts. NERC also must clarify that these penalty amounts are per-violation in its compliance filing. If this clarification results in an adjustment of the penalty amounts listed in the table, NERC must explain its rationale for any adjustment.

ii. Final Adjustment Factors

449. NERC lists a number of Final Adjustment Factors that the ERO or a Regional Entity may consider in determining whether to increase or decrease the Base Penalty

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[174] Although Bonneville posits that the "economic choice" principle is equivalent to a Final Adjustment Factor covering whether a particular violation was intentional, we disagree. The "economic choice" principle is intended to ensure that the penalties that the ERO or a Regional Entity impose have a sufficient deterrent effect; the existence of an intentional violation would constitute an aggravating factor in a particular case that could be used to increase the penalty assessed above a Base Penalty Amount, if appropriate.

[175] Rules of Procedure, app.4, § 4.1.1.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Amount for a specific violation. NERC also proposes that, in a particular penalty determination, the ERO or Regional Entity may consider other, unidentified factors and "facets" not specified in the Sanction Guidelines.

450. This consideration of "other" factors does not, as Bonneville and others suggest, offend fundamental principles of due process by permitting unlimited discretion in levying penalties. To the contrary, consistent with FPA section 215(e)(6) and the Commission's *Policy Statement on Enforcement*, NERC provides fair notice to regulated entities by setting forth an illustrative, non-exclusive list of factors that the ERO and Regional Entities may consider in assessing a penalty.[176] However, we direct NERC to explain its statement in the Sanction Guidelines that "[g]enerally speaking, the effects of the various factors will be compounded together somewhat formulaically to determine the penalty for a violation."[177] If NERC contemplates the application of a generic formula, NERC should provide the formula and explain it. We decline Bonneville's suggestion to broadly delete factors NERC identifies in the Sanction Guidelines, absent any showing that a specific penalty factor is generically irrelevant or inappropriate.

451. The Sanction Guidelines are not intended to establish fixed penalty amounts; they instead provide flexible guidance as establishing an appropriate amount within the range of applicable penalties. The ERO's inclusion of factors not specifically enumerated is reasonable because such an aggregate "catch-all factor" allows for the consideration of mitigating or aggravating factors, relating to a particular violation, that are currently unforeseeable. Indeed, we have placed such a "catch-all" factor in the *Policy Statement on Enforcement* and in our regulations governing the assessment of civil penalties pursuant to FPA section 31 with respect to hydroelectric projects.[178]

452. As for the comments of Ameren and others concerning consistency of penalties that ERO and the Regional Entities would assess using discretionary penalty factors, we

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[176] Order No. 672 at P 561. NERC models many of its factors on those announced in our *Policy Statement on Enforcement*, which articulates the factors the Commission considers when determining an appropriate civil penalty under its newly-enhanced civil penalty authority. *See Enforcement of Statutes, Orders, Rules, and Regulations*, 113 FERC ¶ 61,068 (2005) (Policy Statement on Enforcement).

[177] Rules of Procedure, app.4, § 3.13.

[178] "We recognize that no list can cover every possible significant factor, and we will consider other pertinent factors as appropriate." *Policy Statement on Enforcement* at P 17 (2005). In determining proposed civil penalties relating to hydroelectric projects, the Commission will consider "[w]hether there are any other pertinent considerations" in addition to ten enumerated factors listed in section 385.1505(b)(1)-(10) of our regulations. 18 C.F.R. § 385.1505(b)(11) (2005).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

strongly agree that the ERO must promote consistency and uniformity in the rational application of the Sanction Guidelines and assessment of penalties. However, the employment of a penalty within the authority of the ERO or a Regional Entity is not rendered invalid in a particular case because it is more severe than penalties imposed in other cases.[179] In all cases, however, if the ERO or a Regional Entity were to consider a factor or impose a penalty that bears no reasonable relation to the seriousness of the violation or that fails to take into consideration the remedial efforts of a user, owner, or operator of the Bulk-Power System, the ERO or Regional Entity would exceed its authority, and such a factor or penalty would be deemed unreasonable.[180]

453. WECC argues that any penalty determination should not be "discretionary," but rather must be limited to an "objective" calculation. FPA section 215(e)(6), which governs the penalty determinations at issue, is inconsistent with WECC's position. By its use of the phrases "reasonable relation" and "shall take into consideration," the statute requires the exercise of judgment and discretion in penalty determinations by the ERO and Regional Entities. Therefore, it is reasonable that the calculation of any penalty will involve both objective and discretionary considerations.

454. Moreover, as EEI urges, in each particular penalty determination, the ERO or Regional Entity must list each of the Final Adjustment Factors that it believes to be appropriate, as well as any other factors that are not specifically listed in the Sanction Guidelines, and explain how the application of these factors to the relevant facts relating to a violation contributes to the final penalty determination. Such an explanation of how the ERO or a Regional Entity arrived at a penalty amount is central to demonstrate on Commission review that the assessed penalty bears a reasonable relation to the seriousness of the violation. A violator must also have an opportunity to place evidence in the record of a penalty determination relating to any adjustment factor it believes may be relevant to the amount or type of penalty to be imposed.

455. We concur with Bonneville's contention that the "egregious conduct" factor that NERC proposes the ERO or a Regional Entity must apply before it can impose the maximum possible penalty of $1,000,000 per day per violation is vague and unworkable. Moreover, given that we require the maximum possible penalty to be listed on the Base Penalty Amount Table, the "egregious conduct" factor is superfluous to the extent NERC proposes to use it only as a vehicle for enabling the ERO or a Regional Entity to assess the maximum possible monetary penalty. Thus, we direct NERC to delete the factor in its compliance filing, unless NERC believes that the "egregious conduct" factor may

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[179] *See generally Butz v. Glover Livestock Comm'n Co*., 411 U.S. 182, 187 (1973).

[180] *See, e.g., Bluestone Energy Design, Inc. v. FERC*, 74 F.3d 1288, 1294-96 (D.C. Cir. 1996).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

apply to other possible penalties. If so, we direct NERC to explain generally the circumstances in which such a factor would apply, and how it would affect a Base Penalty Amount.

iii. Other Factors

456. Various commenters ask that we direct NERC to require the consideration of particular factors in penalty determinations. As ISO/RTO Council requests, NERC must amend the Sanction Guidelines to include in its compliance filing as Final Adjustment Factors the organizational structure and not-for-profit status of a particular violator, as we determined in Order No. 672-A.[181]

457. Several commenters urge us to require particular penalty determinations when specific facts are present. However, we do not agree with WECC's proposal that the ERO and Regional Entities impose no penalties for a self-reported first violation, except for severe violations. NERC lists "self-reporting" as a Final Adjustment Factor in its Sanction Guidelines. In appropriate circumstances, self-reporting should serve as a mitigating factor, although we believe that the ERO and Regional Entities must have the discretion to determine the extent to which a penalty should be reduced in a specific case based on its specific facts. Nor do we agree that NERC should establish a process to expunge past violations automatically from an entity's compliance history after a specific period of time, as MRO advocates. While the time period between an entity's current violation and any past violations may be relevant to a penalty determination for the current violation, we believe that consideration of a violator's compliance history is best left to the discretion of the ERO or a Regional Entity.

iv. Multiple Violators

458. Other commenters seek determinations about situations involving multiple violations or multiple violators. Although Bonneville urges that when multiple violations occur, the ERO or a Regional Entity should always impose a penalty at least as high as the penalty that would be imposed for the most serious single violation, we do not support imposing such a bright-line standard. For example, in a specific situation multiple violations may turn out to be cumulative, overlapping, or collectively insignificant. We find merit in International Transmission's observation that NERC does not explicitly address how the ERO or Regional Entities should assess penalties in situations involving multiple violators. Although penalties in such situations should be determined on a case-by-case basis, we direct NERC to submit in its compliance filing generic policies that apply to multiple violations, multiple violators or other recurring situations to assure greater consistency in such matters.

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[181] Order No. 672-A at P 56.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

459. Northern Indiana's citation of section 3.5 of the Sanction Guidelines for the proposition that the ERO or a Regional Entity could impose a penalty before a violation is confirmed appears based on a misinterpretation of the provision. NERC proposes there that the ERO or a Regional Entity could direct a "violator" to take remedial actions at any time, including prior to the confirmation of a violation, which would take place following an appropriate hearing process. Such remedial actions are distinct from the imposition of a monetary or non-monetary penalty. However, we believe that NERC should substitute "entity" for the term "violator" in that provision. We confirm, as Northern Indiana requests, that the determination of a violation and consideration whether a penalty is appropriate should take place at the same time and before the same adjudicator.

v. Non-monetary Penalties

460. We note that, unlike a remedial action, a non-monetary penalty must be submitted to the Commission before it can become effective. We disagree with Bonneville that non-monetary penalties should be limited to those minimally necessary to remedy effects on reliability or to bring an entity into compliance. Rather, the ERO and Regional Entities must impose non-monetary penalties as appropriate, consistent with the Sanctions Guidelines, and not seek to impose the minimum non-monetary penalty automatically. We also decline to disapprove Sanction Guideline 5 and its associated reliability watchlist, as suggested by Bonneville.[182] The watchlist is an important tool whose purpose and effect is to notify the public and other industry participants of an entity's compliance record so as to encourage violators to be delisted by refraining from future violations.

461. We are not persuaded by National Grid's argument that NERC's presentation in the Sanction Guidelines of more detail on monetary penalties than on non-monetary penalties is inconsistent with NERC's statement that it has no preference for monetary penalties over non-monetary penalties. Nevertheless, the ERO and Regional Entities should consider whether non-monetary penalties are more appropriate with respect to specific violations than monetary penalties, such as the situations described by National Grid in which particular violators could lack financial resources to pay monetary penalties.

462. ISO/RTO Council's suggestion that it would be premature for the Commission to accept NERC's proposed penalty matrix now is moot because we are directing NERC to

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[182] In Sanction Guideline 5, NERC lists notifications of boards of directors, regulators and others as an example of a non-monetary penalty. Because we understand these notifications to be a requirement in the process of imposing penalties, we direct NERC to explain the circumstances under which such notifications would be considered non-monetary penalties.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

amend the Sanction Guidelines in several important respects. In addition to testing its Sanction Guidelines in 2006 without imposing penalties, NERC proposes a six-month "notice period," in 2007 during which the ERO will identify violations, calculate penalties and provide notice to violators, but not actually collect any monies. According to NERC, this practice will afford all parties valuable experience in the implementation of the Sanction Guidelines. NERC's proposal appropriately balances the time needed for NERC to implement the Sanction Guidelines with the countervailing interest in activating the mandatory Compliance Enforcement program as rapidly as possible. Therefore, we reject suggestions by Alcoa, ISO/RTO Council and WECC to lengthen the notice period.

b. Due Process in Investigations and Initial Hearings

463. An ERO candidate must document that it has ERO Rules that provide for fair and impartial procedures and due process for enforcement of Reliability Standards and that explain how each Regional Entity's procedures do so.[183] An ERO candidate must develop procedures to ensure due process and submit them for Commission review with its ERO certification application.[184] There must be uniformity 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.[185]

NERC Proposal

464. NERC's Rules of Procedure provide that NERC and Regional Entity compliance staff "shall have the authority and responsibility to make initial determinations of compliance or noncompliance, and where authorized by the appropriate governmental authority . . . to determine penalties and sanctions. . ."[186] NERC indicates that it will delegate to Regional Entities the responsibility for determining whether entities are in compliance with Reliability Standards and assessing penalties for noncompliance.[187]

465. NERC proposes that Regional Entity compliance staff make initial determinations of compliance or noncompliance and, by using the Sanction Guidelines, determine penalties and sanctions for noncompliance with a Reliability Standard, or issue compliance directives or other remedial actions, where authorized by the appropriate

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[183] Order No. 672 at P 570, 612, 754.

[184] *Id.* at P 494.

[185] *Id.* at P 495.

[186] Rules of Procedure § 402.6.

[187] E.g., NERC Transmittal letter at 66.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

governmental authorities or otherwise authorized. NERC states that Regional Entity enforcement staff shall not have a conflict of interest, real or perceived, in the outcome of their activities, including an investigation or the imposition of a remedial action or penalty, and the Regional Entity shall have a conflict of interest policy in effect. A Regional Entity enforcement program may call upon independent technical experts who have no conflict of interest to provide technical advice or recommendations in investigations, audits or reviews of self-reported violations.

466. A Regional Entity shall make available a Regional Entity hearing process for Bulk-Power System users, owners and operators to contest a finding of noncompliance, penalty, or a remedial action. A Bulk-Power System user, owner or operator will be afforded the opportunity to present facts to rebut such a finding. The board of directors of a Regional Entity or a compliance panel reporting directly to the Regional Entity board, with appropriate recusal procedures, will conduct this type of hearing. NERC states that the Regional Entity process for hearing contested violations and any penalty levied with respect to such a violation will be fair, independent, and nondiscriminatory. A Regional Entity must inform NERC of all such hearings, and NERC may observe any proceedings.

467. NERC provides that a Regional Entity may enter into a settlement process relating to alleged violations of Reliability Standards and any associated monetary penalty or remedial action. NERC's proposed Rules of Procedure require that NERC be notified of all settlement processes and may participate in any such process.

Comments

468. Ameren asks that the Commission require the ERO and each Regional Entity to maintain a record of communications and documents related to an investigation and a written record of each enforcement decision, including evidence relevant to the decision to impose a penalty or a sanction. Such records could facilitate comparison of enforcement procedures and development of precedent on types of violations and penalties so entities receive notice of potential penalties. EEI adds that NERC's Rules of Procedure do not establish requirements for what a record should include; how it will be produced, such as a written summary, stenographic transcript or audio recording; how long it will be maintained; or whether it can be supplemented. ESI supports maintenance of a clear record of enforcement proceedings.

469. ISO/RTO Council perceives a possible conflict of interest in the ERO because, while enforcing Reliability Standards, it proposes to develop tools, such as tagging software and Interchange Distribution Calculator software, to assist entities in complying with particular standards. Similarly, NPCC contends that the ERO should not have both responsibility for ensuring compliance with standards relating to personnel certification and responsibility for certifying personnel.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

470. California ISO suggests that a Regional Entity's professional and technical staff report directly to the Regional Entity board, rather than to stakeholder committees, to assure independence in compliance and enforcement matters. To avoid the appearance of unfairness or lack of objectivity when Regional Entity staff seek input from Regional Entity members in connection with investigations, audits and compliance activities, as section 403.7 of NERC's proposed Rules of Procedure permits, California ISO asks that any procedure for peer input from Regional Entity members be fair, balanced, nondiscriminatory and allow input from all industry segments.

471. California ISO observes that, while section 403.4 of the Rules of Procedure explicitly provides for recusal procedures for a Regional Entity board or compliance panel of such a board with respect to conducting compliance hearings, section 403.19 of the Rules of Procedure does not expressly apply a recusal policy to the hearing process for contested violations and penalties or sanctions that a "regional entity compliance enforcement program" must establish and maintain. California ISO submits that section 403.19 of the Rules of Procedure should include a recusal requirement.

472. EEI does not find a clear distinction between the activities of Regional Entity enforcement staff described in section 403.6 of the Rules of Procedure, who would make initial determinations of compliance or noncompliance and levy penalties, and the Regional Entity board or compliance panel, which, pursuant to section 403.4 of the Rules of Procedure, would hold hearings in which persons who receive notice of an alleged violation may contest a finding of alleged violation or a penalty, sanction or remedial action. Moreover, although NERC's proposed section 403.4 of the Rules of Procedure covers hearings of contested findings or penalties, EEI does not find any due process protections detailed in NERC's Rules for other matters.

473. EEI asks for clarification on how a Regional Entity would approve a settlement. SERC is concerned that NERC's proposal to allow settlements at the regional level has the potential for conflicting results. MRO observes that NERC has not proposed any guidelines or processes for settling violations to ensure consistency across Regional Entities. EEI, MRO, SERC and TAPS want NERC to review and approve settlements to assure consistency; EEI adds that NERC should state the precedential effect of negotiated settlements. In reply comments, WECC states that it has no objection to the ERO's review of all settlements and negotiations to promote consistency, but believes that the ERO should not have the power to overturn a settlement unilaterally. WECC instead proposes that, if the ERO determines that the settlement is inconsistent with its interpretation of Reliability Standards or other jurisdictions' approaches, the ERO should advise the settling parties of its concerns and direct them to review the settlement. If the parties cannot thereafter agree to a settlement, WECC contends that the matter should be resolved through applicable processes.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC Reply Comments

474. NERC states that it understands the need for consistency across the Regional Entity compliance programs and, to assure that consistency, it has reserved the right to participate in Regional Entity settlement processes in section 403.18 of the Rules of Procedure, and will review all settlements prior to filing a notice of penalty with the Commission. NERC will make public a settlement of a compliance proceeding once the matter is concluded.

Commission Conclusion

475. While NERC indicates that it plans to delegate enforcement functions to Regional Entities, the Rules of Procedure also rightfully provide that NERC will maintain the ability to conduct its own investigations (e.g., Appendix 8) and enforcement actions (e.g.,. section 402.6). NERC, however, does not provide any framework regarding how it will conduct a hearing or due process protections throughout the enforcement process. While some general information is provided regarding the contemplated hearing process to be established by a Regional Entity, we find that the Rules of Procedure are lacking in detail in this respect as well.

476. The Commission agrees with the comments of EEI and FirstEnergy that the ERO and Regional Entities must have in place clear, uniform due process procedures that provide certainty, consistency and clarity to all who are subject to Reliability Standards and at every stage of review. In its compliance filing, NERC must specify the due process procedures for audits, investigations and initial hearings that the ERO and Regional Entities are to follow in its Rules of Procedure. This direction is consistent with our requirement elsewhere in this order that delegation agreements set forth a detailed enforcement process that mirrors the ERO's enforcement process. As an example of the level of specificity we seek, we suggest that NERC consider the model employed by the National Association of Securities Dealers (NASD) and approved by the Securities and Exchange Commission (SEC), which incorporates a comprehensive set of procedures for disciplining those who violate the NASD's rules, the federal securities laws, or SEC regulations.[188]

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[188] *See, e.g.*, NASD Bylaws and Code of Procedure *available at* http://nasd.complinet.com/nasd/display/index.html. Notwithstanding the utility of the NASD model, for due process purposes the ERO and RE should consider that the NASD is a voluntary association and private corporation that receives no federal or state funding, its creation was not mandated by statute, and the government has no voice in the selection of its members.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

477. We agree with Ameren, ESI and EEI that the ERO and Regional Entities must maintain a written record of all communications and documents related to an investigation and initial hearing.[189] A comprehensive record will be essential to the ERO's review of any Regional Entity action, and the Commission's review of any ERO or Regional Entity action. We direct NERC to specify the requirements for the creation and maintenance of a record. Because we expect that many violations will result in settlement, the NASD's Code of Procedure offers a useful model for the necessary components of a record which NERC should consider when revising its process in its compliance filing.[190]

478. With regard to the conflict of interest issues raised by the ISO/RTO Council, NPCC, California ISO and EEI, we direct NERC to specify how it intends to address the potential for conflicts of interest to ensure independence and impartiality of those charged with investigations of possible violations of Reliability Standards and those charged with adjudication of alleged violations. The issue of conflicts of interest touches many aspects of the enforcement of Reliability Standards, including but not limited to the maintenance and supervision of Regional Entity professional and technical staff, contracting with third party experts or vendors, the composition of Regional Entity boards and compliance committees, and recusal procedures. As such, in its compliance filing, NERC must craft a comprehensive set of parameters for all Regional Entities to follow when crafting their own "conflict of interest" policies. In no event should the fairness, integrity or public reputation of the ERO or Regional Entities be called into question because of insufficient "conflict of interest" parameters or policies.

479. EEI, TAPS and others suggest that the ERO review and approve all settlements by Regional Entities. NERC explains in its reply comments that, to assure consistency, it has reserved the right to participate in Regional Entity settlement processes, and will review all settlements prior to filing a notice of penalty with the Commission. We find that the measures proposed by NERC, along with other safeguards such as regional audits and periodic assessments, provide adequate oversight to assure consistency. If future experience shows an unacceptable level of inconsistency among Regional Entity settlements, NERC may propose, or the Commission may require, a change in these Rules. In response to EEI's comment regarding the precedential value of settlements, we note that, while fairness and consistency in settlements across regions is a goal, negotiated settlements should not constitute binding precedent in future cases. We agree with WECC that the ERO should have the ability to approve or reject a settlement. If the

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[189] In addition, we direct NERC to extend the record requirement to the audit context.

[190] *See, e.g.*, NASD Code(s) of Procedure 9000 series *et al*. Rule 9270(c) describes the required contents of an offer of settlement.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

ERO rejects a settlement, it may propose a modification to the settlement and request the parties to review the proposal. If the parties do not accept the proposed modification, they may resolve the matter through the adjudication and appeals process. These procedures are consistent with the Commission's own practices concerning settlements. We encourage settlements and we do not expect the ERO to reject them as a normal practice.

c. Appeals to the ERO

480. An ERO candidate must develop fair, independent, non-discriminatory and well-defined procedures for appeals and submit them to the Commission for approval with its certification application.[191] The ERO candidate must state whether the appeal of a penalty imposed by a Regional Entity must be at the ERO or Regional Entity level.[192]

NERC's Proposal

481. NERC proposes that an entity appealing a Regional Entity's final decision that finds a violation of a Reliability Standard or imposes a penalty for such a violation shall file a notice of appeal with the ERO's director of compliance, with a copy to the Regional Entity, within 21 days after issuance of the Regional Entity's final decision. The appeal may not include any factual material that was not first presented during the Regional Entity's enforcement proceeding. Within 21 days after receiving a copy of the notice of appeal, the Regional Entity must file with the ERO's director of compliance its response to the notice of appeal and the entire record of the matter, with a copy to the appealing entity. The appealing entity may file a reply to the Regional Entity's response within seven days. NERC states that the Compliance Committee of the ERO's board of trustees, in its discretion, may invite representatives of the appealing entity and the Regional Entity to appear before it, and will decide the appeal in writing based upon the notice of appeal, the record, the response and any reply. This decision will be final, except for any appeal to the appropriate governmental entity.

482. NERC states that no person having a direct interest in a challenge or appeal by a Regional Entity or a regional reliability organization may participate in any aspect of the challenge or appeal except as a party or witness.

483. NERC provides that a condition of invoking the challenge and appeal process pursuant to sections 409 and 410 of the Rules of Procedure is that the entity requesting the challenge or appeal must agree to a "hold harmless" provision in proposed section 411 of the Rules of Procedure. The provision states that the entity must agree that neither

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[191] Order No. 672 at P 612.

[192] *Id.* at P 611.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the ERO, any person assisting in the challenge or appeal process, nor any company employing a person who assists in the challenge or appeal process shall be liable, and shall be held harmless "against the consequences of any action or inaction or of any agreement reached in resolution of the dispute or any failure to reach agreement as a result of the challenge or appeals proceeding," except for matters constituting gross negligence, intentional misconduct, or a breach of confidentiality.[193]

Comments

484. SERC is concerned that full adjudications of reliability violations at the Regional Entity level could lead to inconsistency of results, but believes that NERC's proposed appeal process for Regional Entity adjudications will help minimize inconsistency.

485. California Commission suggests that the process for appealing enforcement actions should reflect appropriate deference to regional organizations, such as WECC, that already manage reliability functions. Reflecting its concern about the potential complexity of the process for appeal of enforcement actions, California Commission recommends that a single appeal from regional reliability organizations' enforcement actions occur at the regional level, where the actions and issues originated. California Commission asserts that NERC should validate and support a primary regional enforcement role rather than interjecting itself into the appeals process.

486. California Commission would limit appeals to interpretations of standards and not permit re-litigation of facts established by a regional reliability organization. WECC asserts that clearly defined and predetermined penalty levels would eliminate the need for appeals of penalty amounts, although parties should be allowed to appeal findings of violations. EEI believes there should be a consistent procedure for appeals of findings, but NERC's proposed process for reliability readiness reviews includes an extended appeal process, including mediation by a neutral, that does not apply to other appeals.

487. California Commission recommends that a single appeal of NERC actions by Regional Entities or regional reliability organizations occur at NERC, with subsequent appeals at the Commission. EEI claims that, in proposed section 409 of the Rules of Procedure, a Regional Entity or a regional reliability organization that challenges an ERO enforcement determination appears to receive an additional level of appeal compared to a user, owner or operator of the Bulk-Power System that appeals a Regional Entity penalty determination. This difference is an example of inconsistency in NERC's proposed due process procedures, in EEI's view. EEI also asks why NERC's compliance and certification committee must provide a hearing for appeals to NERC by Regional Entities and regional reliability organizations pursuant to proposed section 409.4 of the Rules of

[193] Rules of Procedure § 411. In this provision, "NERC" is defined as including its members, board of trustees, committees, subcommittees, staff and industry volunteers.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Procedure, while a hearing before the Compliance Committee will occur only in the committee's discretion for appeals by Bulk-Power System users, owners and operators pursuant to section 410.5 of the Rules of Procedure.

488. Requesting that the Commission delete NERC's proposed "hold harmless" provision in Rules of Procedure section 411 relating to appeals because it violates due process, PG&E suggests that the Commission instead require NERC to indemnify any employees or consultants from any actions performed within the scope of their duties for NERC in a manner similar to indemnification agreements entered into by NASD and the North American Energy Standards Board (NAESB).

489. California ISO requests that the Commission modify NERC's proposed Rules of Procedure 403.4 and 403.19 to provide that, if a Regional Entity compliance committee or a panel of such a committee conducts enforcement hearings and decides enforcement matters, the committee or panel include representation from all industry segments to reflect balanced representation and ensure fair, independent and nondiscriminatory process.

Commission Conclusion

490. We construe the procedures NERC submits with respect to enforcement actions initiated by Regional Entities as providing for an initial charge or allegation of violation by the Regional Entity's compliance staff, following or in connection with a self-report, audit or investigation. After the compliance staff notifies a user, owner or operator of the Bulk-Power System of the allegation, the user, owner or operator would have an opportunity for a hearing process in which to contest the allegation. Following the hearing, the Regional Entity board or a balanced committee established by the Regional Entity board would serve as a final adjudicator of the staff's allegation of violation and any proposal by the compliance staff for remedial action or a monetary or non-monetary penalty. NERC then proposes that an entity may contest a final Regional Entity adjudication by filing an appeal at the ERO. As such, we interpret NERC's application as proposing a single appeal at the ERO level of a Regional Entity's final determination as to a violation and any remedial action or penalty that may apply. However, section 403.19 of the Rules of Procedure implies a dual appeal process, first at the Regional Entity, then at the ERO, by stating that if a user, owner or operator of the Bulk-Power System has completed a Regional Entity's hearing process and desires to "continue appeals," it shall appeal to NERC. We direct NERC, in its compliance filing, to amend this provision and any other provision of its Rules that may be inconsistent with NERC's determination to lodge appeals of a Regional Entity penalty determination with the ERO.

491. We disagree with commenters who ask us to reject NERC's choice of appeal forum and amend NERC's Rules and the *pro forma* delegation agreement to place the appeal at the Regional Entity, with a subsequent opportunity for review at the

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission. We also decline to limit NERC's authority on appeal to review penalty amounts or determinations on other issues that implicate the ERO's objective to achieve consistency in enforcement actions. Both proposals would minimize NERC's role as the ERO to ensure consistency and encourage uniformity with respect to enforcement of Reliability Standards. Therefore, we agree that the ERO should have de novo review authority on appeal in matters where consistency is desirable, such as the interpretation of standards, the application of penalty factors to specific facts, and whether the factual record supports a particular penalty or remedial action. NERC's procedures afford appropriate deference to the Regional Entities' role as reliability managers and their familiarity with operating conditions by prohibiting consideration on appeal of any fact that is not in the record compiled by the Regional Entity. Moreover, we expect the ERO to provide appropriate deference to the Regional Entity's determinations of fact in specific cases. We agree that appeal procedures to NERC with respect to compliance matters heard by Regional Entities must not differ depending upon whether the matter first arose in an investigation, compliance audit or self-report, or in a reliability readiness review. NERC must so state in its compliance filing.

492. We observe that NERC states that it will review penalties levied by each Regional Entity for violations of Reliability Standards for consistency with similar violations and fairness in application. It is not clear whether NERC intends to review each such penalty, even when an entity does not contest a determination of a violation, remedial action or imposition of a penalty, or whether this review would use the appeal procedures set forth in NERC's Rules. In its compliance filing, NERC must explain its review process and state how it would differ from the appeal process.

493. NERC's application does not refer to an opportunity to appeal a determination of a violation, remedial action or penalty assessment that the ERO may make with respect to one or more Bulk-Power System users, owners or operators. We direct NERC to submit for approval in its compliance filing appeals procedures at NERC that would follow such a determination.

494. NERC's procedures provide that a Regional Entity or a regional reliability organization may challenge an allegation of a violation made by the ERO's enforcement staff. The ERO's compliance and certification committee will hear the challenge. The Regional Entity or regional reliability organization may appeal the compliance and certification committee's determination to the compliance committee of the ERO board of trustees. We disagree with EEI, and find that the challenge and appeal process described above embodies the "single appeal" we found appropriate in Order No. 672. In a challenge, as described in section 409.4 of the Rules of Procedure, a Regional Entity or regional reliability organization would receive the same right to a hearing that a user, owner or operator of the Bulk-Power System would receive during the initial hearing

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

process described in section 407.3 of the Rules of Procedure. In the event that NERC's Compliance Committee reviews a challenge, we agree that it should reflect balanced representation and ensure fair, independent and nondiscriminatory process.

495. We direct NERC to explain in its compliance filing why it should not indemnify employees or consultants who participate in appeals processes, as suggested by PG&E, and delete the "hold harmless" provision of section 411 of the Rules of Procedure. The indemnification procedures appear more direct and less broad than the "hold harmless" provision.

d. Notice of Penalty and Appeal to the Commission

496. Section 39.7(d) provides that a notice of penalty that the ERO files with the Commission 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 ERO or the Regional Entity, as appropriate, may find relevant. Simultaneously with the filing of a notice of penalty with the Commission, the ERO shall serve a copy of the notice of penalty on the entity that is the subject of the penalty.[194]

NERC Proposal

497. NERC proposes in its application that Regional Entities will provide all penalties, and remedial actions, including compliance directives, to the ERO for review and filing with applicable governmental authorities as a notice of penalty. However, the Rules of Procedure do not set forth the information that the ERO should provide in the notice. NERC states that, where authorized by applicable legislation, no penalty shall take effect until the thirty-first day after the ERO files with the applicable governmental authority a notice of penalty and the record of the proceedings in which the violation and penalty were determined.

Comments

498. Georgia Operators, asserting that NERC's application fails to express the Commission's final authority on enforcement or other actions that substantively affect entities' rights or obligations with respect to Reliability Standards, recommends that the Commission's right of review and final authority be clearly expressed so that misunderstandings do not occur. To discourage non-meritorious appeals to the

[194] 18 C.F.R. § 39.7(b) and (c)(2) (2005).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission of penalties, International Transmission requests the Commission to clarify that during its review of penalties, it would stay them sparingly or require payment into escrow of penalties that have been appealed.

Commission Conclusion

499. Because section 39.7(d) sets forth in detail the contents of a notice of penalty the ERO will file with the Commission, NERC need not include specific details about notices of penalty in its Rules. Nor do we believe it necessary for NERC to refer in its Rules to the Commission's final authority on enforcement of Reliability Standards: that authority is described in FPA section 215 and the Commission's regulations.

500. It is unclear whether NERC intends to submit a notice of penalty to the Commission for an ERO or Regional Entity compliance directive that is not related to a penalty assessment. The notice of penalty is the procedural vehicle for the ERO to inform the Commission of a penalty assessment, thereby beginning the 31-day period required by FPA section 215(e)(2) before a penalty may become effective. We direct NERC to amend its Rules, in its compliance filing, to clarify that it will not file a notice of penalty with the Commission concerning an ERO or Regional Entity compliance directive that is not related to a penalty assessment.

501. Finally, at this time, we decline to establish a policy relating particularly to stays of, or escrow arrangements relating to, ERO or Regional Entity penalties about which we receive a notice of penalty.

e. ERO Monitoring of Regional Entity Compliance

502. NERC states that the ERO will have a program to monitor the enforcement program of each Regional Entity that has been delegated authority. Further, ERO compliance staff will monitor Regional Entity or regional reliability organization compliance with NERC Reliability Standards.[195] Section 409 of NERC's Rules of Procedure sets forth procedures for a Regional Entity or regional reliability organization to challenge an ERO finding of noncompliance, imposition of a penalty or an audit finding.

503. Pursuant to the proposed procedures, a Regional Entity or regional reliability organization may file a notice of the challenge with the ERO's director of compliance within 21 days of issuance of the audit finding or notice of violation. After an opportunity for the NERC enforcement program to respond, the ERO's compliance and certification committee will provide the Regional Entity or regional reliability organization and the ERO enforcement program an opportunity to be heard and shall

[195] NERC Rules of Procedure § 404.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

decide the matter based upon the filings and presentations made, with a written explanation of its decision. A Regional Entity or regional reliability organization may file a notice of appeal with NERC's director of compliance within 21 days after issuance of the Compliance and Certification Committee's decision. The Compliance Committee of NERC's board of trustees will decide the appeal in writing. This decision will be final, except for any appeal to the appropriate governmental entity.

Comments

504. Because NERC proposes that the ERO compliance and certification committee hear disputes over findings of violation by and imposition of penalties on Regional Entities, Ameren and ESI believe that NERC should provide an adequate explanation of the proposed committee's membership, scope and charter. EEI asserts that it is critical for NERC to file with the Commission the charters for committees such as its Compliance and Certification Committee, so the Commission can assess the extent that these committees support the ERO's key objectives. EEI also asks that NERC's Rules describe the scope, functions, makeup, procedures, and accountability of the Compliance and Certification Committee, as well as any compliance committees of Regional Entities, and ensure that these committees receive sufficient "legal input" to enable their actions to meet due process standards.

Commission Conclusion

505. We accept NERC's proposal for providing due process for Regional Entities that seek to challenge an ERO compliance action or audit finding, subject to NERC addressing in a compliance filing the specific concerns discussed below. First, we note the requirement that that section 409.1 of NERC's Rules of Procedure apply only to a "regional reliability organization wishing to challenge a finding of noncompliance . . .," whereas the remainder of the section applies to both Regional Entities and regional reliability organizations. NERC should revise section 409.1 to apply to Regional Entities as well.

506. We share the concerns of commenters regarding the need for additional information about the compliance and certification committee that will act as the ERO's adjudicative body. Accordingly, NERC should provide additional details regarding the Compliance and Certification Committee, including a description of the Committee's functions, who is eligible to serve on the Committee and how members are chosen, how many members will comprise a hearing panel, whether the hearing panel will decide matters by majority vote, the disqualification or recusal process for Committee members, whether those involved in the investigation of the matter will be barred from serving as an adjudicator on the same matter, and other procedures of the Committee that will apply when determining a challenge to a compliance action or audit finding.

F. Delegation Agreements

507. Section 39.8 of the Commission's regulations permits the ERO to enter into an agreement to delegate authority to a Regional Entity for the purpose of proposing to the ERO and enforcing Reliability Standards. The delegation agreement must include a statement demonstrating that: (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 under section 215(c) of the FPA; and (3) the agreement promotes effective and efficient management of the Bulk-Power System.

1. *Pro Forma* Delegation Agreement Requirements

508. The Commission observed that there is value to consistency among the Regional Entity delegation agreements. Standardization of key elements of these delegation agreements will facilitate uniformity in ERO-Regional Entity relationships, Regional Entity processes, accountability and enforcement of Reliability Standards, and may also help minimize seams between regions. In Order No. 672, the Commission emphasizes that the processes of Regional Entities should be uniform unless regional facts, other than custom, require a difference. The Commission thus required the ERO candidate to file a *pro forma* delegation agreement concurrently with its application that would contain core elements to be uniformly applied to all Regional Entities. The Commission states that any regional differences and unique system needs, including any needs particular to Cross-Border Regional Entities could be addressed by attaching addenda to each Regional Entity's individual delegation agreement.

a. Uniformity of Delegation Agreements

NERC Proposal

509. In its April 4, 2006 application, NERC provides a proposed *pro forma* delegation agreement. Under the agreement, each Regional Entity must represent to the ERO that it will meet the statutory and regulatory requirements for governance and has developed programs and procedures for standards development and regional enforcement.[196]

510. NERC's proposed *pro forma* delegation agreement includes exhibits to be customized by each Regional Entity in its individual delegation agreement. Included in the exhibits are the requirements which a Regional Entity designed standards

[196] ERO Application, exh. D, *Pro Forma* Regional Delegation Agreement at 5 (*Pro Forma* Regional Delegation Agreement).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

development procedure and a regional enforcement program must meet. The resulting standards development procedures and enforcement program provides for the enforcement of Reliability Standards within the geographic boundaries of a Regional Entity.

Comments

511. Most commenters express concerned that the *pro forma* delegation agreement does not include all areas that should be uniform across all Regional Entities. One commenter asserts that the *pro forma* is sufficient as proposed; while others assert that the proposed *pro forma* is too prescriptive.

512. A number of commenters, including Alcoa, Ameren, EEI, ELCON and MRO[197] support consistency in the delegation agreements of Regional Entities, particularly with regard to compliance and enforcement procedures. Alcoa contends that the language of NERC's application is inconsistent with the Commission's mandate that delegation agreements between the ERO and Regional Entity must be standard and uniform. MRO asserts that there should be a single delegation agreement that defines the entire relationship between the ERO and a Regional Entity.

513. EEI emphasizes that the Regional Entity delegation agreements should be the same or highly consistent, particularly with respect to enforcement, because numerous users, owners and operators of the Bulk-Power System will operate in more than one Regional Entity. It emphasizes that general assurances or promises to develop a consistent process or procedure are insufficient. Alcoa argues that consistent individually-negotiated delegation agreements are no substitute for a *pro forma* delegation agreement. Ameren believes that the individual delegation agreements should deviate from the *pro forma* only if a Regional Entity can show that the change is necessary, not just desirable.

514. APPA asserts that NERC's proposed *pro forma* delegation agreement is sufficient as proposed and should be adopted without significant modifications. It recommends that the Commission signal its preference for consistency in the individual delegation agreements, particularly with regard to enforcement, standards development and funding.

515. WECC and FRCC indicate the *pro forma* delegation agreement is too prescriptive. WECC asks the Commission to find that the *pro forma* delegation agreement is non-binding guidance for final negotiations between Regional Entities and the ERO and to clarify that negotiated deviations from the *pro forma* delegation agreement are

[197] *See also*, Constellation, Entergy, ReliabilityFirst, and Wisconsin Electric.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

permissible. FRCC asserts that the *pro forma* delegation agreement is not the product of a full consensus among the regions and should be modified to facilitate agreement between each region and the ERO.

516. EEI asserts that the Commission should require specific showings by each proposed Regional Entity demonstrating that it has complied with the provisions of the *pro forma* delegation agreement, the attached exhibits, and provisions of the NERC Rules applicable to them. EEI contends that if the Commission determines that there are deficiencies in a particular individual delegation agreement, it should conditionally approve the delegation agreement for that Regional Entity with specific requirements for changes to be submitted before final approval.

NERC Reply Comments

517. NERC agrees with commenters that the Regional Entity delegation agreements should be as uniform as possible. However, NERC notes that the delegation agreements are likely to differ in some respects. It notes, for example, that section 215 of the FPA authorizes different forms of governance among Regional Entities. NERC states that all of the Regional Entity delegation agreements will have a standard set of exhibits that contain the details of each Regional Entity's enforcement program. It describes the exhibits, which are the same as those filed in the *pro forma* delegation agreement, to be included in each Regional Entity delegation agreement.

Commission Conclusion

518. Because Order No. 672 requires an ERO candidate to submit a *pro forma* delegation agreement with an ERO certification application, NERC essentially had 60 days to negotiate and draft the *pro forma* delegation agreement. The Commission commends NERC's efforts to negotiate the *pro forma* delegation agreement within a short timeframe. While NERC's proposed *pro forma* delegation agreement lacks detail on a number of elements, we agree with APPA that it provides an adequate foundation on which to build individual delegation agreements. We will not require NERC to submit a revised *pro forma* delegation agreement that provides details that are currently lacking before negotiating the individual delegation agreements. As we have indicated previously, the changes to the *pro forma* delegation agreement that we direct throughout this order should be reflected in the individual delegation agreements. However, once it has established the default provisions for the delegation agreements, including the changes required in this order and negotiated in the delegation agreements, NERC should resubmit the *pro forma* delegation agreement.

519. Order No. 672 emphasizes the value of uniformity and states that regional processes should be uniform unless regional facts, other than custom, require a

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

difference.[198] As the Commission observed in Order No. 672, standardization of these agreements will facilitate uniformity in the enforcement of Reliability Standards and may help to minimize seams between regions.[199] While the Commission anticipated that certain regional processes would be standardized in the *pro forma* delegation agreement, it appears that there was simply not sufficient time to achieve this. The Commission nonetheless remains committed to achieving uniformity in the individual delegation agreements and expects NERC and the Regional Entities to reach agreement on uniform processes and procedures when negotiating and drafting the delegation agreements. Any deviation from the uniform elements must be identified and justified. Failure to justify a deviation may result in rejection of a delegation agreement or acceptance conditioned on compliance with Commission direction.

520. We discuss below specific areas where uniformity should be reflected in the individual executed delegation agreement. For example, the individual delegation agreements should include a uniform process for proposing a Reliability Standard and a uniform detailed enforcement process, which mirror the respective processes of the ERO. This consistency across regions will ensure compliance with Order No. 672, streamline the administration of the ERO program, and reduce the compliance burden on users, owners and operators located in more than one region. To facilitate greater consistency, NERC may wish to offer "default" exhibits regarding compliance/enforcement and standards development that address those matters that should be uniform across the regions. Although the exhibits filed with the *pro forma* agreement contemplate uniformity in many areas, they are drafted as general principles only, not with specific language to govern a particular enforcement program or standards development process. Once such default language is drafted by NERC, in coordination with the regions, a prospective Regional Entity could either adopt the default option for a particular process or explain why its alternative approach is consistent with or superior to the default option given its particular facts. We urge NERC to employ this approach in working with the regions to develop greater consistency in delegation agreements.

521. The Commission disagrees with WECC and FRCC that NERC's proposed *pro forma* delegation agreement is too prescriptive and should be treated as non-binding guidance for final negotiations with a Regional Entity. Rather, as discussed above, the *pro forma* delegation agreement is reasonable as far as it goes and the Commission's primary concern is that it does not contain *enough* detail. However, Order No. 672 does anticipate that regional differences and unique system needs may be addressed in addenda to the delegation agreements, including the need to address differing authorities

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[198] Order No. 672 at P 53, 737.

[199] *Id*. at P 712.

of Cross-Border Regional Entities.[200] Thus, the negotiation of individual delegation agreements presents NERC and the Regional Entities with the opportunity to account for unique circumstances within a particular region while maintaining uniformity among all individual agreements across all regions.

b. Negotiation of Individual Delegation Agreements

NERC Proposal

522. NERC stated in its certification application that it plans to negotiate and execute delegation agreements with Regional Entities within 90 days of certification. NERC notes, however, that a Regional Entity delegation agreement will not be effective until it has been approved by the Commission in accordance with section 39.8(b). Exhibit F of the proposed *pro forma* delegation agreement states that the delegation agreement for each Regional Entity will include a description of and timetable for the actions that a Regional Entity will take to implement provisions of the delegation agreement.

Comments

523. Commenters recommend that the period for negotiation of delegation agreements be extended from 90 days after certification to 180 days after certification. The California Commission, California IOUs, and the California ISO comment that NERC's plans to negotiate and execute regional delegation agreements within 90 days of certification will not allow sufficient time to ensure balanced representation on the boards of Regional Entities or adequately incorporate stakeholder input into the process. The California ISO and California IOUs assert that NERC should allow at least 180 days to negotiate and execute the Regional Entity delegation agreements. The California ISO asks for additional time to resolve the issues associated with developing a governance structure that is fully supported by members in the region and consistent with statutory requirements.

524. Several commenters, including EEI, MRO and TAPS,[201] suggest that the ERO should submit the individual delegation agreements simultaneously. EEI comments that the ERO should submit the Regional Entity delegation agreements to the Commission for approval in a single process so that the Commission can determine if the specific Regional Entity's showings meet the statutory requirements and are consistent with each other and ERO procedures. TAPS warns the Commission to avoid the "race to the bottom," which could well result from sequential submission and ruling by the Commission. MRO agrees, asserting that an iterative approval process for each Regional

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[200] *Id.*

[201] *See also*, Ameren and Wisconsin Electric.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Entity will likely create differences that are contrary to the concept of a *pro forma* agreement and may prolong final execution of the delegation agreements, as Regional Entities jockey for position on approvals.

525. MRO suggests that NERC establish a due date for delegation agreements to be submitted with completed attachments and should then review all of the delegation agreements at one time, with an eye toward consistency and implementation within a reasonable time. EEI suggests that the Commission also conditionally accept the compliance programs proposed by the Regional Entities and order specific changes to be made in compliance filings in accordance with a schedule designed to ensure that changes are made in time for the Regional Entities to assume their duties under the delegation agreement.

NERC Reply Comments

526. NERC states that each Regional Entity delegation agreement will be a contract between NERC and the Regional Entity that delegates to the Regional Entity certain portions of NERC's authority as the ERO to carry out specified functions regarding developing Reliability Standards and enforcing compliance with Reliability Standards. It describes the delegation agreement as a voluntary agreement that sets forth the terms and conditions under which delegated functions will be carried out and notes that, until there is an agreement between the parties, there is nothing to submit to the Commission for approval.

527. NERC states its intention to file the negotiated Regional Entity delegation agreements for Commission approval later this year, after receiving certification as the ERO and completing negotiations with prospective Regional Entities. NERC's objective is to file all of the Regional Entity delegation agreements simultaneously, if possible, so the Commission and stakeholders will be able to evaluate them for consistency.

Commission Conclusion

528. In its application, NERC indicated that it plans to negotiate and execute delegation agreements within 90 days of certification. While NERC's statement is informative, we do not read it as binding. NERC has the discretion to negotiate and execute individual delegation agreements in the time frame that it deems fit. Accordingly, the Commission sees no need to "extend" the window from 90 to 180 days or set any other "due date" as requested by some commenters.

529. Likewise, while the Commission sees some merit to suggestions by commenters that NERC collectively submit the individual delegation agreements, we will not direct NERC to do so, and leave this matter to NERC's discretion. Nor is it appropriate for the Commission to limit its discretion by committing to a specific review process.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

530. However, once NERC is established as the ERO in this order and Reliability Standards are approved in Docket No. RM06-16-000, the ERO is responsible for enforceing Reliability Standards in each region until a delegation agreement is approved and a Regional Entity is operational for that region. We therefore believe that it is important to have each Regional Entity in place before the summer 2007 peak season to fully promote Bulk-Power System reliability and to not require the ERO to be the only line of enforcement for the entire North American grid.

c. Boundaries of a Regional Entity

NERC Proposal

531. NERC's proposed *pro forma* delegation agreement includes a placeholder for each Regional Entity to provide a description of the geographic and electrical boundaries covered by the agreement. The regional boundaries should also reflect any coordination with neighboring Regional Entities to ensure that all areas are included within the geographic boundaries of a Regional Entity.[202]

Comments

532. Ameren requests that the Commission require NERC to clarify how it will reconcile differences in regional boundaries. While Exhibit A of the proposed *pro forma* delegation agreement will require a Regional Entity to specify the geographic and electrical boundaries it proposes to cover and reflect coordination with neighboring regions, it does not specifically require that a particular system, geographic or electrical boundary be included within the boundaries of one and only one Regional Entity. Thus, a potential conflict between Regional Entities is a real possibility. Ameren suggests that NERC should address this problem by adding a process for reconciling boundary differences to Exhibit A. This process should include the opportunity for the owners and operators of the system, geographic or electrical boundary in question to present a case to NERC for inclusion in one of the Regional Entities in the dispute and should clarify that once a Regional Entity's membership has been determined, that determination will preclude another Regional Entity from asserting authority over that entity.

533. ReliabilityFirst and Wisconsin Electric note that NERC's application would require Regional Entities to specify the electrical footprint for which they are responsible. It urges the Commission to fix these footprints after approval for at least the initial term of the delegation agreement to prevent stakeholders from moving from one Regional Entity to another.

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[202] *Pro Forma* Regional Delegation Agreement, exh. A at 20.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission Conclusion

534. The Commission agrees with Ameren that conflicts could arise regarding the boundaries of adjacent Regional Entities. It is important that the footprint of a Regional Entity makes sense from a reliability perspective and does not overlap with another regional footprint. Accordingly, the Commission directs NERC to explain in its compliance filing how it will address such conflicts.

535. The Commission stated in Order No. 672 that any change in 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.[203] In response to ReliabilityFirst's and Wisconsin Electric's comment, the Commission agrees that there is a need for stability with regard to the footprint of a Regional Entity. We believe that this review process provides sufficient protection for stakeholders moving from one Regional Entity to another. If this proves to be a problem in the future, the Commission may revisit this issue.

d. Regional Entity Governance

NERC Proposal

536. The proposed *pro forma* delegation agreement lists five governance requirements that a Regional Entity must meet. The first is the statutory requirement that a Regional Entity must be governed by an independent board, a balanced stakeholder board, or a combination independent and balanced stakeholder board. The other requirements are that the Regional Entity establish Rules that: (1) assure its independence while assuring fair stakeholder representation in the selection of its director; (2) assure balance in its decisionmaking committees and subordinate organizational structures; (3) provide reasonable notice and opportunity for public comment, due process, openness, and balance of interest in exercising its duties; and (4) assure that no two industry sectors can control and no one industry sector can veto any action.

Comments

537. Commenters, including Ameren, EPSA, and California IOUs, acknowledge the statutory provisions allowing for certain differing forms of governance of a Regional Entity, but suggest that NERC should include in its application a description of the process it intends to use to evaluate the governance of a Regional Entity. International Transmission asserts that the ERO should carefully consider the level of independence of a Regional Entity's governance in determining whether to enter into a delegation agreement with a Regional Entity, and that the Commission should do likewise in

[203] Order No. 672 at P 671.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

reviewing any such delegation agreements. The California IOUs request that the Commission direct NERC to develop criteria to evaluate whether a Regional Entity's board is balanced. Similarly, EPSA recommends that the Commission issue guidelines to encourage and promote maximum uniformity relating to the concept of balanced stakeholder boards.

538. Ameren also recommends that Exhibit B of the *pro forma* delegation agreement be modified or deleted so there is no confusion about the acceptable composition of a Regional Entity's board. As stated now, it seems to allow only independent directors for Regional Entities and, as such, conflicts with Item 1 and section 215(e)(4)(A) of the FPA.

539. The California ISO asserts that the Commission should require NERC to modify the Rules of Procedure to ensure that inputs into Regional Entity enforcement, as well as the composition of any Regional Entity hearing panel or committee, are fair, non-discriminatory and reflect balanced representation of all industry segments. It also expresses a preference that a Regional Entity board be independent. If a Regional Entity's board is not fully independent, then it should be a hybrid board in which the majority of the board seats are held by independent trustees. The California ISO also suggests that a Regional Entity's board should not exceed 10 to 12 members and should have an independent professional and technical staff that reports directly to the board, not to stakeholder committees, to ensure actions are taken in a fair and non-discriminatory manner.

540. The California ISO also contends that ISOs/RTOs must be separately represented on any Regional Entity stakeholder or hybrid board because the interests of ISOs/RTOs cannot be adequately represented by any other industry segment. In addition, the California ISO asserts that there should be a mechanism to ensure that transmission operators that serve a significant portion of the load in a region are adequately represented in the governance and standards-setting processes and that there should be a correlation between the megawatts of load served by a transmission operator and representation on a Regional Entity's board.

541. SERC, Santee Cooper and MEAG urge the Commission to find that SERC's proposed board membership and voting procedures satisfy the Regional Entity requirements contained in section 215 of the FPA.

542. In its reply comments, WECC contends that the Commission should make it clear that a Regional Entity may be governed by an independent board, a balanced stakeholder board or a combination independent and balanced stakeholder board. WECC asserts that, contrary to comments by the California ISO, PG&E and SoCal Edison contending that unspecified modifications are needed to WECC's existing board governance in order to meet the requirements under section 215(e)(4)(A), WECC's current board fully meets these broad criteria.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission Conclusion

543. As noted by WECC, section 215 of the FPA permits a Regional Entity to choose its form of governance from among an independent board, a balanced stakeholder board or a combination of the two. In Order No. 672, the Commission does not give further guidance regarding statutory criteria for governance, noting instead that it will interpret statutory criteria in light of the facts presented in each Regional Entity's proposed delegation agreement.[204]

544. While commenters suggest that NERC should include a description of the process it intends to use to evaluate the governance of a Regional Entity, the Commission believes that governance should be left sufficiently open, consistent with the statute, to allow flexibility for Regional Entities to find a governance structure appropriate to their regions. In particular, the Commission believes it is inappropriate to express a preference for an independent board over a hybrid board when the statute provides that either form of governance is permitted. Further, the Commission sees no need to prescribe limits on board composition, representation of industry segments or otherwise ensure adequate representation beyond the requirements already provided in Order No. 672 and section 215 of the FPA.

545. As part of their individual delegation agreements, the ERO and the Regional Entities must include Rules providing that no two industry sectors may control any decision and no single segment may veto any matter, unless the ERO adequately explains why it cannot apply these principles.[205] The Commission believes these Rules will provide the necessary assurance of balanced representation and independence from the users, owners and operators of the Bulk-Power System.

546. With regard to requests from commenters that the Commission endorse the governance structure of SERC, it is premature to make a finding on any particular prospective Regional Entity's governance at this time. The Commission will rule on each Regional Entity's governance structure when it is before the Commission as part of the individual Regional Entity delegation agreements.

e. Relationship Between the Regional Entity and the ERO

NERC Proposal

547. NERC's proposed *pro forma* delegation agreement delegates authority, pursuant to section 215(e)(4) of the FPA, to a Regional Entity for the purpose of proposing

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[204] *Id.* at P 727.

[205] *Id.* at P 728.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Reliability Standards to NERC and enforcing Reliability Standards within the geographic boundaries set forth in Exhibit A.

Comments

548. Several commenters express support for a strong ERO with primary responsibility for performing all reliability functions, with Regional Entities subordinate to the ERO.[206] Alcoa asserts that NERC's proposal delegates too much authority to the Regional Entities and asks the Commission to require NERC to modify provisions of the *pro forma* delegation agreement to ensure delegation of authority from the Commission to the ERO, then to the Regional Entities, in that order only. ELCON comments that the relationship between NERC and the Regional Entities should be clarified to provide NERC with strong top-down authority and to promote uniformity in the development, implementation and enforcement of Reliability Standards. It asserts that the regions should not be granted any residual authorities they had in the old regime, except where allowed by statute, and asks for clarification that the regions do not have the discretion to develop and implement inconsistent approaches.

Commission Conclusion

549. As a general matter, the Commission agrees with commenters regarding the need for a strong ERO. This need is a major objective of Order No. 672 and we reiterate our conclusion from Order No. 672 that primary responsibility for performing all reliability functions rests with the ERO. The ERO retains responsibility to ensure that a Regional Entity implements its enforcement program in a consistent manner.[207] The Commission will clarify specific aspects of NERC's application below with regard to the ERO's authority as needed in the relevant provisions of the *pro forma* delegation agreement.

f. Specific Terms in NERC's Proposed *Pro Forma* Delegation Agreement

i. Covenants

NERC Proposal

550. In section three, Covenants, the Regional Entity agrees to maintain and preserve its qualifications for delegation; in addition the Regional Entity agrees not to amend its Rules without NERC's approval. NERC agrees to maintain its qualification and status as

[206] *See* Alcoa, Constellation, EEI, ELCON and FirstEnergy.

[207] Order No. 672 at P 654.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the ERO, and not to adopt amendments to the Rules of Procedure that affect the rights, obligations or programs of the Regional Entity without first obtaining the Regional Entity's consent.[208]

Comments

551. Alcoa suggests modifying *pro forma* section 3(b) such that the ERO need not seek the consent of a Regional Entity before modifying a Rule, standard, or procedure.

552. EEI asserts that the legal basis for requiring a Regional Entity to comply with Reliability Standards should be clarified. Section 215 does not expressly grant authority to the Commission to enforce a Reliability Standard against a Regional Entity. However, a number of the Version 0 standards will be applicable to Regional Entities, in that they require them to develop a Reliability Standard. EEI suggests revising section three of the *pro forma* to bind each Regional Entity to comply with all Commission-approved NERC Reliability Standards. EEI proposes an insertion to section three stating that: "During the term of this Agreement, [Regional Entity] shall comply with all approved NERC Reliability Standards, all applicable NERC Rules of Procedure, and all applicable the Commission orders and rules."

553. EEI observes that while this may be a "fix" for this apparent problem, at a more fundamental level, apart from requirements for Regional Entities to develop Reliability Standards, Regional Entities should not be subject to Reliability Standards as are users, owners and operators of the Bulk-Power System under FPA section 215(b). To clarify this division of responsibilities between Regional Entities and functional entities, the Commission should require changes to proposed section 404 of the Rules to eliminate references to enforcement by the ERO for standards applicable to a Regional Entity.

Commission Conclusion

554. The Commission agrees with Alcoa that the ERO need not seek the consent of a Regional Entity before modifying a Rule, standard or procedure unless that change actually conflicts with, rather than merely affects, a Regional Entity's rights, obligations or programs. Allowing a Regional Entity the authority to overrule a proposed ERO Rule any time it might "affect" the Regional Entity is inconsistent with our goal of creating a strong ERO.[209] We agree, however, that a Regional Entity must be able to rely on, and enforce, its contractual rights under its delegation agreement and therefore, if a Regional Entity believes that a Rules changes conflicts with the rights set forth in its agreement, the Regional Entity should be able to object or take action in accordance with section 16

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[208] *Pro Forma* Regional Delegation Agreement at 6.

[209] *See, e.g.*, Order No. 672 at P 654.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

of the *pro forma*, as discussed below. A Regional Entity will be provided ample opportunity for participation in the modification process for Rules, standards and procedures. The Commission therefore directs NERC to revise section 3(b) of the *pro forma* delegation agreement accordingly.

555. While we share EEI's concern regarding the source of authority to bind a Regional Entity to comply with a Reliability Standard, this is an issue that relates to specific proposed Reliability Standards and, thus, should be addressed in Docket No. RM06-16-000 relating to NERC's proposed Reliability Standards. However, we disagree with EEI that the Commission should require changes to the Rules of Procedure to eliminate references to enforcement. Consistent with our disposition of the related matter of regional reliability organizations, Regional Entities should be listed on the compliance registry as discussed in that section of this order. The matter of whether a Regional Entity must comply with Reliability Standards is a function of the scope and applicability of the Commission-approved Reliability Standards and will not be addressed in this proceeding.

ii. Reliability Standards

NERC Proposal

556. The Reliability Standard provision contained in section five of NERC's proposed *pro forma* delegation agreement entitles a Regional Entity to propose Reliability Standards, regional variances, or modifications, which NERC will consider through an open and inclusive process that affords reasonable notice and opportunity to be heard. A Regional Entity may develop regional Reliability Standards and regional variances if it is organized on an Interconnection-wide basis, through an open process set forth in Exhibit C of the proposed *pro forma* delegation agreement.[210] A regional Reliability Standard or regional variance developed through such a process will be reviewed by NERC, but not re-vetted through NERC's open Reliability Standards development process.

Comments

557. Alcoa argues that the proposed *pro forma* delegation agreement should not entitle a Regional Entity to propose Reliability Standards because of the potential for duplicating the efforts of the ERO. Regional Entities should be able to propose *either* a regional Reliability Standard or a regional variance but, to ensure nationwide consistency, responsibility for Reliability Standards must rest with the ERO. Alcoa recommends amending section 5(a)(i) of the *pro forma* delegation agreement to prevent a Regional Entity from circumventing the ERO by appealing directly to the Commission in the event that the ERO does not approve a regional Reliability Standard or regional variance.

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[210] *Pro Forma* Regional Delegation Agreement at 7.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

558. Allegheny comments that language in the proposed *pro forma* delegation agreement improperly limits the proposal of regional variances to Regional Entities that are Interconnection-wide. It asserts that section 2(a)(ii) of the proposed *pro forma* delegation agreement, which allows a Regional Entity to develop Regional Reliability Standards and regional variances if the Regional Entity is organized on an Interconnection-wide basis, and a similar provision in section 5(a)(ii), are ambiguous and require clarification. Allegheny asserts that the need for regional variances will not be limited to Interconnection-wide Regional Entities and the opportunity for each Regional Entity to develop these variances should not be limited by this agreement.

559. Ameren comments that the *pro forma* delegation agreement should make it clear that any proposed regional difference in Reliability Standards must be based on real, physical differences from one region to the next, especially for differences among regions within the same Interconnection.

560. Bonneville strongly supports NERC's inclusion in the delegation agreement of the FPA requirement that proposals for a Reliability Standard or modification to a standard to be applicable on an Interconnection-wide basis be rebuttably presumed to be just, reasonable, not unduly discriminatory or preferential, and in the public interest. Bonneville supports the language that such a proposal should be rejected only on the basis of substantial evidence, emphasizing that each Interconnection must be able to design reliability requirements that are applicable to its particular circumstances and reliability issues.

561. The California Commission asserts that the *pro forma* delegation agreement should be modified to include an explicit provision, requiring the ERO to rebuttably presume that a proposal for 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 a proposal is from a Regional Entity organized on an Interconnection-wide basis. The California Commission also recommends that the description of the standard-setting process in the *pro forma* delegation agreement be clarified to state that the compliance program will monitor compliance with the standards applicable in the particular region or states in question, taking into account any established variances.

Commission Conclusion

562. Although Order No. 672 states that only the ERO may submit a proposed Reliability Standard to the Commission, each Regional Entity should be able to appeal NERC's decision not to approve a proposed regional Reliability Standard or variance and forward it on to the Commission.[211] The Commission will review such appeals to

[211] Order No. 672 at P 654.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

determine if NERC's decision was proper, taking into account any applicable presumptions. NERC should ensure that the individual delegation agreements contain this provision.

563. With regard to Allegheny's assertion that the proposal of regional variances should not be limited to Interconnection-wide Regional Entities, the Commission notes that anyone, including a Regional Entity, may propose a Reliability Standard to the ERO for its consideration. While only an Interconnection-wide Regional Entity will receive the rebuttable presumption that its proposal for a Reliability Standard to be applicable on an Interconnection-wide basis is just, reasonable, and not unduly discriminatory or preferential, and in the public interest, any Regional Entity may propose such a standard.

564. With regard to Ameren's comment, Order No. 672 discusses circumstances under which a regional difference would be allowed. It is not necessary for the ERO applicant to repeat explicitly every provision of that order.

565. The Commission notes that section 5 already includes an explicit provision for the rebuttable presumption for a Reliability Standard proposed by an Interconnection-wide Regional Entity, and thus, the California Commission's suggestion is not necessary. Furthermore, section five of the *pro forma* delegation agreement relates to Reliability Standard development not monitoring and enforcement. Accordingly, we will not direct NERC to modify the section to state that a Regional Entity's compliance program will monitor compliance with the standards applicable in the particular region as suggested by the California Commission.

iii. Enforcement

NERC Proposal

566. NERC's proposed *pro forma* delegation agreement requires a Regional Entity to enforce Reliability Standards within its geographic boundaries as set forth in the compliance program in section six Exhibit D. The Regional Entity may not materially change its compliance program without NERC's approval. The Regional Entity agrees to comply with the NERC Rules in implementing this enforcement program, subject to limitations on amendments to NERC Rules and dispute resolution.[212]

Comments

567. Commenters observe that NERC's proposed *pro forma* delegation agreement contains little detail on its enforcement process. Ameren comments that the proposed *pro forma* delegation agreement contains only broad principles as to how a Regional Entity's

[212] *Pro Forma* Regional Delegation Agreement at 8-10.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

compliance program should operate. It asserts that the Commission should direct the ERO to establish specific standards for compliance procedures to be included in a revised Regional Entity delegation agreement so that enforcement activities will be consistent across regions.

568. As discussed in the enforcement and delegation sections of this order, EEI requests that the Commission order a proposed Regional Entity to file its proposed enforcement process in detail to enable interested parties to evaluate the proposal as a condition of the Commission's approval of a Regional Entity delegation agreement. In particular, EEI contends that NERC's proposed enforcement process lacks appropriate due process procedures.[213] It emphasizes that the ERO and Regional Entities must have due process procedures as stringent and legally sustainable as the Commission's because they will have the statutory authority to make public findings of violations and impose substantial monetary fines and other sanctions. EEI asserts that any delegation agreement submitted to the Commission for review must contain due process procedures to be conducted by Regional Entities and suggests that the Commission should order NERC to develop model due process procedures to be included in the enforcement process of each Regional Entity's delegation agreement.

569. NRECA raises concerns about a provision in section 6 that contemplates that the Regional Entity may make non-material changes in its enforcement program without NERC's approval, but provides no examples or explicit criteria for deciding which changes are and are not material. NRECA believes that additional specificity (especially examples of non-material changes) would be helpful in avoiding potential ambiguity in this area. It asserts that anything that relates to the Reliability Standards themselves or the level and nature of compliance should require NERC's approval.

Commission Conclusion

570. Order No. 672 directs that a strong ERO ensure that each Regional Entity implement its enforcement program in a consistent manner.[214] The Commission agrees with commenters that the proposed *pro forma* delegation agreement lacks sufficient detail in its description of the uniform, standardized provisions of the Regional Entity enforcement program, consistent with our discussion in the enforcement section of this order. The Commission also agrees with EEI that a discrete due process procedure is an essential part of a Regional Entity's enforcement program. Before the Commission will approve an individual Regional Entity delegation agreement, it must include a detailed enforcement process with specific compliance procedures, including the specific steps in the investigation process, triggering events, due process and confidentiality protections,

[213] *See also*, Entergy and FirstEnergy.

[214] Order No. 672 at P 486, 654.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

among other things. As discussed earlier regarding our general concern on the lack of specificity in certain provisions of the *pro forma* delegation agreement, these procedures must be consistent from one Regional Entity to the next, unless a deviation is identified and sufficiently justified. A delegation agreement that lacks consistency or an explanation for such difference may be rejected or accepted on condition that it submit a compliance filing.

571. We agree with NRECA and direct NERC to clarify in the individually negotiated delegation agreements what it means by "non-material" changes in section 6. Providing greater specificity on this issue will reduce the potential for disputes over whether a particular change is material or not. We also note that, as stated in section 39.10 of the Commission's regulations, a proposed Regional Entity Rule change must be approved by the Commission.

iv. Funding

NERC Proposal

572. In section eight of the *pro forma* delegation agreement, NERC describes the scope of activities to be funded through the ERO in support of delegated activities and activities that are in furtherance of NERC's responsibilities as the ERO under section 215, as specified in the NERC Rules. These activities include: (1) Reliability Standard development; (2) enforcement; (3) organization registration and certification; (4) reliability readiness review and improvement; (5) reliability assessment and performance analysis; (6) training and education; and (7) situational awareness and infrastructure security.[215]

573. Section eight of NERC's proposed *pro forma* delegation agreement also requires a Regional Entity to submit unaudited interim quarterly financial statements no later than 20 days after the end of the fiscal quarter.

Comments

574. The California Commission and APPA note the beneficial functions currently performed by regional reliability councils and assert that Regional Entities should have the flexibility to perform functions that are not required by section 215 of the FPA. The California Commission asserts that NERC's application needs to be revised to protect the integrity and funding of regional planning and assessment activities. It expresses concern that the scope and content of activities approved for funding could be less than the scope and content of the assessments that are desired, needed and practiced by a region.

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[215] *Pro Forma* Regional Delegation Agreement, exh. E at 24.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

575. APPA asserts that the Commission should not take actions that would limit the ability of Regional Entities to perform non-statutory functions, provided that such activities do not present a conflict of interest that cannot be addressed through a separation of functions or control from the Regional Entity's enforcement program. APPA believes it would constitute a conflict of interest for a Regional Entity or an affiliate to directly perform market or transmission service functions or any NERC operating authority function, including certification as a Reliability Coordinator, balancing authority or transmission operator. If necessary, Regional Entity compliance programs to carry out statutory activities can be established with separate corporate identities, governance and employee benefit programs.

576. The California Commission proposes changing the functional separation language in the enforcement attachment to the *pro forma* delegation agreement from the requirement to maintain a segregation of specifically delegated reliability activities from other reliability activities to a more pragmatic requirement to separate responsibilities sufficient to ensure no conflict or appearance of conflict. The California Commission argues that the current wording could be read to imply a requirement for an absolute, unquestioning segregation of activities, which is inefficient and may be detrimental to reliability.

577. Georgia Operators contends that various parts of NERC's application seem to provide for separate and overlapping concurrent roles for regional reliability organizations, or regional reliability councils, and Regional Entities. It notes that whether an entity performs activities as a Regional Entity or a regional reliability organization has budget implications. For example, data gathering activities for reliability assessment are not included in the *pro forma* delegation agreement but instead are assigned to regional reliability organizations in the Rules. These functions could be assigned to Regional Entities, with the associated costs paid from the ERO's budget.

578. FRCC contends that the requirement for Regional Entities to submit unaudited quarterly interim financial statements in a form provided by NERC in section 8(h) of the *pro forma* is unreasonable and bureaucratic and is not justified by the statute or Order No. 672.

Commission Conclusion

579. Consistent with our determination in the NERC funding and budgeting discussion of this order, the Commission agrees with the California Commission and APPA that Regional Entities should have the flexibility to perform beneficial functions that are currently performed by regional reliability councils. Order No. 672 states that the Commission will not prohibit a Regional Entity from performing other reliability-related

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

functions outside of the statutory functions of proposing and enforcing Reliability Standards. A Regional Entity may conduct such activities, provided that they do not conflict with the performance of a delegated function, which is the primary function of a Regional Entity.[216]

580. Any additional activity performed by a Regional Entity must not compromise its oversight role or independence and must not present a conflict of interest with its oversight role of transmission operators. Funding for the activity must not be of such a significant amount or from a source as to compromise the independence of a Regional Entity. Other activities not explicitly funded under section 215 of the FPA may not be funded through the ERO.[217] Thus, consistent with our discussion in the funding section of this order, a Regional Entity must include in its budget amounts for activities not expressly listed in the *pro forma* delegation agreement. These activities should not present a conflict and should be consistent with a statutory requirement. The individual regional delegation agreements should list such activities and the Commission will rule on that list when it otherwise acts on the delegation agreement.

581. The Commission disagrees with the California Commission's proposal to change the functional separation language in the enforcement attachment to the *pro forma* delegation agreement, which requires a segregation of delegated reliability activities from other activities. The Commission believes that separation is needed to ensure that the delegated functions of a Regional Entity do not subsidize other activities.

582. In order for data collection activities to be considered a statutory activity, as suggested by Georgia Operators, the ERO must designate such an activity as a statutory function required for Bulk-Power System reliability or adequacy assessments. Further, in regard to their possible overlapping activities, as discussed in the governance section, we have required NERC to explain the relationship between regional reliability organizations and Regional Entities.

583. The Commission disagrees with FRCC's assertion that the filing of unaudited quarterly interim financial statements is unreasonable. The filing of such statements is necessary for the ERO to determine whether each Regional Entity budget is adequate to carry out its functions and to ensure that any ERO-approved funding is appropriately expended for delegated functions.

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[216] Order No. 672 at P 656.

[217] *Id.* at P 657.

vi. Assignment

NERC Proposal

584. Section nine, Assignment, states that the delegation agreement may be assigned by either party only with the prior written consent of the other. A Regional Entity may not delegate its delegated authority to any other entity, but may contract with other entities to assist it in carrying out its delegated duties, provided that it retains control and responsibility over such duties. The activities are listed on Exhibit E and were detailed above in the discussion on statutory versus non-statutory functions and in the following section on Regional Entity funding.

Comments

585. Alcoa contends that the provision in the proposed *pro forma* delegation agreement providing a Regional Entity with the ability to contract with another entity concerning its delegated responsibilities is contrary to the statute's provisions concerning delegation. The delegation agreement should be revised to provide that no contracting with other entities regarding a Regional Entity's delegated function can occur without prior NERC approval.

Commission Conclusion

586. The Commission disagrees with Alcoa's assertion that a Regional Entity may not contract with another entity to fulfill delegated duties. The Commission explicitly permits the use of consultants and subcontractors in Order No. 672.[218] In this regard, we note that, while a Regional Entity may sub-contract, section 1205 of the Rules of Procedure provides that a Regional Entity may not sub-delegate any responsibilities or authorities delegated to it by NERC pursuant to the delegation agreement. We clarify that this means that a Regional Entity bears ultimate responsibility for any functions carried out on its behalf.

vii. Default and Cure

NERC Proposal

587. Under the terms and conditions of default and cure, the non-breaching party will inform the breaching party in writing of the breach. The breaching party will have thirty calendar days to cure the breach. If the breach cannot be cured in thirty calendar days, the breaching party will work continuously and diligently to complete the cure within ninety calendar days. If the breach is cured in 90 calendar days, then the breach will be

[218] Order No. 672 at P 177.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

cured. However, if the breach is not cured, the non-breaching party will have the right to declare a fault and terminate the delegation agreement with written notice, provided that termination of the delegation agreement will be suspended during dispute resolution.

Comments

588. Alcoa observes that the draft entitles a breaching party a right to attempt to cure the breach, and permits termination only in the event that cure does not occur or if such a breach is not capable of being cured. It asserts that these restrictions limit the ERO's ability to hold the Regional Entity accountable and thus are not in the public interest. The agreement must provide a means by which the ERO can unilaterally terminate a Regional Entity's delegated authority upon a finding that it was unwilling or unable to comply with the ERO's Rules of Procedure or the terms of the delegation agreement, or otherwise exceeded its authority.

Commission Conclusion

589. The Commission finds that the default and cure provision is sufficient as written. The Commission believes that allowing the breaching party the opportunity to cure the breach before it can determine they are unwilling or unable to comply is reasonable. We disagree that this will not hold a Regional Entity accountable. In the event a breach is not cured, the non-breaching party may declare default and terminate the agreement. Further, under section 215 of the FPA, the Commission may take such action as is necessary and appropriate against or a Regional Entity to ensure compliance with any Commission order affecting the ERO or a Regional Entity, including any order approving or modifying a delegation agreement. If a Regional Entity it was unwilling or unable to comply with the ERO's Rules of Procedure or the terms of the delegation agreement, the Commission has the appropriate tools to hold the Regional Entity accountable.

viii. Term and Termination

NERC Proposal

590. Section 11 of the *pro forma* delegation agreement states that the agreement shall become effective thirty days after the date of issuance of a final Commission order accepting the agreement for filing without requiring any changes to the agreement unacceptable to either party. The delegation agreement shall have a three-year initial term and may be renewed for another five-year term. If the Agreement is not renewed or terminated the parties will work to ensure a smooth transition of the delegated authority back to the ERO or another eligible entity. If the transitional period is more than 180 days, the Regional Entity may unilaterally terminate the agreement.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

591. Alcoa notes that NERC's proposed *pro forma* delegation agreement currently provides that NERC and the Regional Entity each have the ability to unilaterally terminate the delegation agreement only if it finds a holding, modification, or condition imposed on the delegation agreement to be unacceptable and the parties are unable to renegotiate a mutually acceptable resolution. It asserts that the delegation agreement must be revised to provide that the ERO may terminate a Regional Entity's delegation of authority for cause upon finding that it has failed to comply with the Rules of Procedure or terms of the delegation agreement, or has otherwise exceeded its authority.

592. EEI is concerned that if a Regional Entity elects to terminate the contract, 90 days is insufficient time to ensure that all of the Regional Entity's duties will be taken over by NERC, another Regional Entity, or in some other manner. A one-year notice provision is more appropriate.

593. Northern Indiana notes that a typographical error in section 11(c) affects the termination of the delegation agreement. The last sentence of section 11(c) states termination shall be "effective ninety (180) days following…." NERC should state which time frame was intended.

Commission Conclusion

594. Alcoa's concern regarding the ERO's ability to terminate in the event a Regional Entity refuses to comply with a Rule of Procedure or the delegation agreement is covered under section 10, discussed above. Under that provision, either party may terminate the delegation agreement if the other party defaults.

595. The Commission agrees with EEI that the termination provision should be extended to one year to allow sufficient time for another eligible entity to assume the duties of the Regional Entity. Ninety days does not allow adequate time for another entity to take over the enforcement activities of a departing Regional Entity. We hereby direct NERC to revise 11(c) to clarify that termination shall be one year following written notice by the Regional Entity.

viii. Limitation of Liability

NERC Proposal

596. In section 12, the Regional Entity and NERC agree not to sue each other or their directors, officers, employees, and persons serving on their committees and subgroups for any act or omission during the performance of their duties. The Regional Entity and NERC agree, absent a finding of gross negligence or intentional misconduct, neither shall

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

be liable to the other for damages. In the case of gross negligence or intentional misconduct, the party shall not be liable for indirect, incidental, special, multiple, consequential, exemplary or punitive damage.

Comments

597. Alcoa asserts that the "hold harmless" clause in the proposed *pro forma* delegation agreement is improperly broad because it excludes all actions except acts or omissions constituting gross negligence or intentional misconduct. Alcoa suggests amending section 12 to reflect that the ERO and a Regional Entity must be held accountable to the other for all actions and omissions taken in performance of their reliability functions.

Commission Conclusion

598. The Commission rejects Alcoa's suggestion that NERC's proposed hold harmless clause is improperly broad, consistent with our discussion in the governance section of this order. The Commission believes that it is reasonable. In the event a Regional Entity fails to fulfill its reliability functions for reasons other than gross negligence or intentional misconduct, the *pro forma* delegation agreement contains other provisions which allow recourse to the ERO. Further, any entity may file a complaint at the Commission against a Regional Entity for failing to fulfill its reliability functions and the Commission may take any action that is necessary or appropriate to ensure the Regional Entity's compliance with its required responsibilities.

ix. Amendment to the NERC Rules

NERC Proposal

599. Section 16, Amendment to the NERC Rules, states that NERC shall not adopt amendments to the Rules of Procedure that affect the rights, obligations or programs of the Regional Entity without first obtaining the Regional Entity's consent. If the Regional Entity does not consent, NERC shall have the right to invoke dispute resolution, and if dispute resolution fails to resolve the dispute, to petition the Commission to adopt the amendment to the Rules of Procedure. If the Commission issues an order which amends or materially affects the rights or obligations of the Regional Entity, the Regional Entity shall have the option, exercisable no later than 60 days after issuance of the Commission order to terminate the delegation agreement. The termination would be effective 90 days following written notice by the Regional Entity to NERC and the Commission, or when NERC and the Regional Entity agree the termination will be effective.

Comments

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

600. Several commenters[219] assert that section 16 of the *pro forma* delegation agreement shifts the balance of power to the Regional Entities rather than providing the necessary authority to the ERO, and should be amended. They argue that section 16 gives any single Regional Entity veto power over amendments to the ERO's Rules by requiring that each Regional Entity give its consent to a proposed change in the Rules before the ERO's board of trustees can adopt such amendments. This provision allows a single Regional Entity to preclude the board from exercising its statutory authority to amend the ERO Rules.

601. EEI asserts that section 16 potentially locks in the Rules on the day each delegation agreement is executed and may preclude further improvements to the Rules. It recommends revising section 16 to remove the provisions that would give any Regional Entity veto power over proposed changes to NERC Rules. EEI also notes that section 16 also allows a Regional Entity to terminate the agreement if the Commission issues an order that materially affects the rights or obligations of the Regional Entity under the Regional Entity delegation agreement. It supports this provision. Exelon also suggests amending section 16 to eliminate the Regional Entities' veto power and would extend the 90-day termination notice to one year.

602. MRO expresses support for early consultation with Regional Entities. It proposes that NERC clarify the language so that there is early consultation with Regional Entities, in advance of a proposed Rule change, to assure sensible implementation and to permit the Regional Entity to assess its future ability to meet the requirements of the ERO under its delegation agreement. NRECA states that the Regional Entity's ability to terminate the delegation agreement should provide a sufficient check on any perceived excesses.

NERC Reply Comments

603. NERC asserts that section 16 is a critical part of the *pro forma* delegation agreement because it enables the Regional Entity to preserve the agreements and commitments it made when it entered into the delegation agreement. NERC states that the *pro forma* delegation agreement will require the Regional Entity to agree to comply with the ERO's Rules of Procedure. It asserts that the contents of the Rules of Procedure will be known at the time the parties enter into the delegation agreement, and the Regional Entity will be able to know its obligations and responsibilities under the delegation agreement before signing it.

604. NERC contends that a Regional Entity's ability to know and rely on the obligations it assumed when it signed the delegation agreement could be defeated if the ERO were free to modify the Regional Entity's obligations under the delegation agreement by revising its Rules of Procedure. Thus, NERC asserts that section 16

[219] *See* Alcoa, EEI, MRO, NRECA and TAPS.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

provides a fair mechanism for assuring that the ERO can make changes needed to adjust its Rules of Procedure over time, while at the same time preventing the ERO from unilaterally imposing changes in the functions that Regional Entities, by contract, have agreed to perform.

Commission Conclusion

605. The Commission agrees with commenters that section 16 gives a Regional Entity too much power to delay amendments to ERO Rules. As stated above in the discussion on covenants, we are concerned that virtually any change in the ERO Rules could be interpreted as "affecting" a Regional Entity and hence subject to veto or delay by a Regional Entity. As we stress throughout this order, we seek to establish a strong ERO and will not accept provisions such as this which compromise the ERO or that lend authority in establishing Bulk-Power System reliability. The Commission agrees with EEI that a Regional Entity should have the right to terminate its delegation agreement. However, this right must be balanced by the Regional Entity's responsibility to fulfill its delegated duties. The Commission therefore directs NERC to include uniform language in each executed delegation agreement preserving a Regional Entity's option to terminate but limiting the right to instances where the Rule change would "conflict" with rather than "affect" its rights, obligations or programs under its delegation agreement.

606. With regard to Excelon's comment, the Commission agrees with Exelon that the termination notice should be extended to one year to allow adequate time for another entity to take over the enforcement activities within the footprint of a departing Regional Entity. The Commission directs NERC to extend the 90-day termination notice to one year, consistent with our determination above under Term and Termination.

x. Dispute Resolution

NERC Proposal

607. Section 17 sets out a dispute resolution provision in the event a dispute arises under the delegation agreement. It states that in the event a dispute arises under this between NERC and a Regional Entity, a representative of each the ERO and the Regional Entity with authority to settle the dispute shall meet and confer in good faith in an effort to resolve the dispute in a timely manner. If the informal dispute resolution fails, each has the right to pursue all remedies, except as expressly limited by the terms of delegation agreement. Section 17 states that neither party shall have the right to pursue other remedies until the dispute resolution procedures of section 17 have been exhausted.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

608. TAPS asks that NERC be required to modify section 17 to include a specific period for informal dispute resolution efforts (*e.g.*, 30 days, unless mutually agreed), after which NERC should be permitted to file its Rule change with this Commission.

Commission Conclusion

609. The Commission believes that providing a specific period for informal dispute resolution will ensure that disputes are resolved in a timely manner. In Order No. 888, the Commission included language in the *pro forma* Open Access Transmission Tariff similar to that requested by TAPS: "In the event the designated representatives are unable to resolve the dispute within thirty (30) days [or such other period as the Parties may agree upon] by mutual agreement, such dispute may be submitted to arbitration and resolved in accordance with the arbitration procedures set forth below."[220] Although the Commission encourages the ERO and Regional Entities to resolve disputes informally, if this cannot be done, language setting a specific period for dispute resolution allows parties to seek resolution of the dispute in other forums without undue delay. We hereby direct NERC to revise section 17 accordingly.

xi. Governing Law

NERC Proposal

610. Under section 19, Governing Law, parties to the delegation agreement recognize the primary jurisdiction of the Commission to interpret and apply the delegation agreement provided that, if the Commission declines to do so, action will be brought in a state or federal court in New Jersey. Further, when not in conflict with or preempted by federal law, the delegation agreement will be governed and construed in accordance with the laws of New Jersey.

Comments

611. FRCC comments that *pro forma* section 19 is unbalanced because for action initiated by a Regional Entity against the ERO, it fails to require the ERO to bring an

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[220] *See Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002); Section 12 of the *pro forma* OATT.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

action against a Regional Entity in that region; instead, forcing the Regional Entity to come to New Jersey to defend itself. FRCC asks the Commission to require a more balanced and fair provision.

Commission Conclusion

612. Since NERC is headquartered in New Jersey, and NERC will be a party to any action involving a delegation agreement, it is reasonable that, if the Commission declines to rule on a matter involving the delegation agreement, action should be brought in a state or federal court in New Jersey. Because the Commission will have primary jurisdiction over the delegation agreements, instances of this kind are unlikely to occur. Accordingly, FRCC has not convinced us that the provision is unbalanced.

xii. Savings Clause

NERC Proposal

613. A Savings Clause in section 21 of the *pro forma* delegation agreement states that nothing in the delegation agreement will preempt or limit the Regional Entity's authority to adopt reliability requirements or take other actions to ensure the reliability of the Bulk-Power System within the geographic boundaries described in Exhibit A that are outside the authority delegated by NERC, provided that the Regional Entity's reliability requirements and actions are not inconsistent with the Reliability Standards applicable to the region and do not result in a lessening of reliability outside the region.

Comments

614. Alcoa comments that the savings clause of the proposed *pro forma* delegation agreement wrongly suggests that Regional Entities have reliability responsibilities outside of section 215 and recommends that it be revised to clarify that a Regional Entity may not engage in any activity not explicitly delegated to the Regional Entity in compliance with section 215 and the Commission's regulations. To the contrary, the California Commission and NARUC request that the Commission require NERC to revise the Rules of Procedures and *pro forma* delegation agreement to fully reflect the savings clause of section 215(i)(3) of the FPA by protecting states, as well as the Regional Entity, from preemption. It adds that there also needs to be some detailed and meaningful specification of the basis on which a state action might be found to be inconsistent with applicable reliability criteria.

Commission Conclusion

615. The Commission disagrees with Alcoa that the savings clause of the *pro forma* delegation agreement inappropriately suggests that Regional Entities have reliability responsibilities outside of section 215. We have previously clarified that Regional

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Entities may have reliability responsibilities outside of the scope of section 215, notwithstanding the section 215(i) of the FPA savings clause, which explicitly prevents the ERO from preempting the authority of a state to take action to ensure the safety, adequacy and reliability of electric service within that state.

616. We reiterate our discussion in the Reliability Standard development section of this order that regional criteria are standards of behavior of a voluntary nature that are not enforceable under the FPA and they cannot preempt a Commission approved Reliability Standard. As such, these voluntary standards or practices cannot be used to circumvent the mandatory Reliability Standard system. Furthermore, NERC indicates that it is in the process of a review of the status and consistency of the regional criteria and procedures to determine a recommended course of action for each.[221] However, we will not require that this statutory savings clause be included in the *pro forma* delegation agreement, which defines the authority and responsibility of two non-governmental entities.

2. Requirements for Regional Entities in Other Parts of NERC's Application

617. Provisions relating to Regional Entities are included in various places throughout NERC's ERO application. Article X, section 2 of NERC's Bylaws states that the ERO shall be permitted to enter into a delegation agreement with a Regional Entity only if the board determines that the Regional Entity has agreed to promote, support and comply with the purposes and policies of the ERO as set forth the in the Certificate of Incorporation, Bylaws, Rules of Procedure and Reliability Standards.

Comments

618. The California ISO notes that NERC's application sets forth minimum required attributes of a Regional Entity compliance program in section 403 of the Rules of Procedure and that Exhibit D of the *pro forma* delegation agreement also sets forth requirements a Regional Entity must meet with respect to enforcement. It is concerned that the two sets of requirements are not identical. The California ISO requests that the Commission direct NERC to develop a single set of requirements that apply to Regional Entity enforcement programs or direct NERC to: (1) provide expressly that the requirements of section 403 also apply to Regional Entity compliance programs, and (2) indicate whether section 403 or Exhibit D applies in the event of an inconsistency

[221] NERC intends to form a task force to review the status and consistency of the regional criteria and procedures and "fill in the blank" standards, and determine a recommended course of action for each standard. The task force will prepare a report and work plan for board approval on November 1, 2006. NERC is expected to file the report and work plan for approval with the Commission on November 8, 2006. The plan will provide a detailed schedule for addressing all of the regional "fill-in-the blank" standards.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

between the two.

619. FRCC comments that NERC's Rules of Procedure fail to reflect the Regional Entity's right of recourse to the Commission as specified in section 39.8(f) of the Commission's regulations and should be modified accordingly.

Commission Conclusion

620. With regard to California ISO's comments, the Commission directs NERC to resolve the internal inconsistencies regarding the Regional Entity compliance program in its compliance filing. The Commission directs NERC to provide in the individually negotiated delegation agreements that each Regional Entity to must comply with applicable provisions of the Certificate of Incorporation, Bylaws, Rules of Procedure and Reliability Standards to be consistent with NERC's Bylaws. Finally, with regard to FRCC's comment, the Commission disagrees that the ability of a Regional Entity to submit a non-executed delegation agreement to the Commission if negotiations fail needs to be included in the Rules of Procedure. Further, section 39.8(f) of the Commission's regulations sets froth a Regional Entity's right of recourse.

3. Other Contractual Arrangements

NERC Proposal

621. NERC's Bylaws at Article X contain a provision entitled "Other Agreements," that appears to define aspects of the relationship between NERC and a Regional Entity. It states that NERC may enter into an agreement with a Regional Entity to define their respective roles and may address such issues as the development and scope of regional Reliability Standards, enforcement and funding.

Comments

622. National Grid and TAPS observe that NERC's proposed Bylaws contain a provision that would define the respective roles of NERC and the Regional Entity and would address such issues as the development and scope of regional standards, enforcement and funding. National Grid submits that the issues covered in these so called "Other Agreements" are more appropriately included in the Regional Entity delegation agreement. It asserts that carving out separate side deals will undermine the goal of consistency and will unnecessarily complicate efforts of interested stakeholders that seek to understand the relationship between NERC and a Regional Entity. Accordingly, National Grid suggests that Article x, section 3 should be deleted.

623. Similarly, TAPS suggests that the Commission should reiterate Order No. 672's direction that the delegation agreement (with necessary addenda) should describe the

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

relationship between the ERO and its Regional Entities, and direct NERC to minimize use of additional agreements.

Commission Conclusion

624. The Commission agrees with commenters that all statutory activities that are delegated to a Regional Entity should be defined in the Regional Entity delegation agreement, subject to Commission approval. Further, the executed delegation agreements must bind each Regional Entity to NERC's Bylaws and Rules, as appropriate, as required by Order No. 672. The Commission requires NERC to delete Article X, section 3 from its Bylaws when it files its compliance filing, without prejudging that previous delegations approved by the Commission may need to be modified and resubmitted to the Commission for approval from time to time.

G. Reliability, Adequacy and Other Information

625. In order to fulfill their respective responsibilities under the FPA or Order No. 672, the Commission, the ERO or a Regional Entity must access relevant data from users, owners and operators of the Bulk-Power System.[222] Section 39.2(d) of the Commission's regulations provides that each user, owner or operator of the Bulk-Power System within the United States (other than Alaska and Hawaii) shall provide the ERO and the applicable Regional Entity such information as is necessary to implement section 215 of the FPA as determined by the Commission and set out in the Rules of the ERO and each applicable Regional Entity.

626. In addition, section 39.11 of our regulations sets forth the requirement that the ERO conduct assessments of the reliability and adequacy of the Bulk-Power System in North America and report its findings to the Commission and others. The ERO may obtain pertinent information on resource adequacy from any relevant user, owner or operator of the Bulk-Power System.[223]

1. General

NERC Proposal

627. NERC proposes to require that all Bulk-Power System users, owners and operators provide the information necessary to monitor compliance with the Reliability Standards to NERC and each applicable Regional Entity. The Regional Entities and other entities must provide sufficient data and other information requested by NERC in support of the

[222] Order No. 672 at P 114.

[223] *Id.* at P 806.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

annual long-term and seasonal assessments and any special reliability assessments. The applicable Regional Entity will define data retention and reporting requirements in the Reliability Standards and compliance reporting procedures.[224]

628. Section 800 of NERC's proposed Rules of Procedure describes NERC's reliability assessment and performance analysis program. The program includes the use of various reliability assessment reports[225] which are conducted by the Regional Entity, and a team of reliability and technical experts. Under section 804 of the Rules of Procedure, the regional reliability organizations and other entities are required to provide sufficient data and other information as requested by NERC to support the annual long term and seasonal assessments as well as any special reliability assessments. Section 805 of the Rules of Procedure discusses the reliability assessment process. During the process, the team independently assesses the regions' resource adequacy, transmission adequacy and transmission operating reliability, and seasonal operating reliability, the results of which are incorporated into their report, which may also include recommendations for new and or revised Reliability Standards. Section 805 of the Rules of Procedure does not contain a specific provision requiring NERC to share the unredacted report with the Commission.

Comments

629. PG&E contends that NERC's proposed procedures are inadequate because they only require that the ERO analyze resource adequacy as part of the reliability assessment reports, which will be conducted at NERC's discretion. PG&E further contends that NERC proposes to perform only a high-level review of resource adequacy, evaluating regional demand and resource capacity in the context of a region as a whole and the ability of Regional Entities to serve their obligations.

630. Bonneville notes that the most significant transmission outages have occurred under conditions considered highly abnormal. Although section 805 of NERC's Rules of Procedure provides that the assessment may consider unusual but possible operating scenarios and how the system is expected to perform, NERC must include in its reliability assessments all reasonably credible operating conditions (for example, heavy loads, extreme temperatures, loss of resources, loss of transmission, disruptions in or unavailability of fuel supplies).

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[224] Sections 401(3) and 804 of NERC's proposed Rules of Procedure.

[225] The annual reliability assessment reports include reports on the long-term reliability assessment; the summer assessment; the winter assessment; and any special reliability assessment reports which NERC decides are warranted or are requested by the board.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

631. Bonneville further asserts that NERC's assessments of long-term resource adequacy do not evaluate whether the forecasted resources in the region are sufficient to reliably meet the forecasted loads. Therefore, it recommends that if any region or sub-region has established a method to measure resource adequacy and has determined the amount of resources necessary for resource adequacy, then NERC's Long-Term Reliability Assessment Report should state whether the various regions and sub-regions will meet their particular resource adequacy metrics and targets.

632. Similarly, PG&E submits that NERC must evaluate resource adequacy at appropriate levels of granularity to ensure that needs are being comprehensively considered and that appropriate recommendations are formulated.[226] Also, NERC should evaluate the local resource adequacy requirements and compliance thereto for a five-year forecast horizon or longer. Finally, NERC's assessments (and recommendations) should be provided to the appropriate local resource adequacy authorities and should include detailed information about deficient entities (under appropriate confidentiality provisions) to facilitate the implementation of recommendations.

633. Bonneville expresses additional concern that some of NERC's Reliability Standards designate the load serving entity as the entity responsible for reporting forecasted loads and resources. Bonneville suggests that, while the load serving entity is in the best position to know its future loads, NERC should allow flexibility in reporting requirements and allow balancing authorities also to report forecasted loads. Due to the large number of load serving entities in the West, the absence of common definitions and practices in load forecasting, and the possibility that the same resources will be counted more than once all suggest that in many cases an aggregated forecast by the balancing authority may be more appropriate.

634. Georgia Operators contends that data gathering activities for reliability assessment are not included in the Regional Entity delegation agreement but instead are assigned to

[226] PG&E contends that NERC's resource adequacy assessments should provide sufficient detail to identify deficiencies as to resource adequacy requirements, resource adequacy compliance, and systemic or repeated deficiencies by entities or classes of entities within each jurisdiction. PG&E recommends that NERC's data collection and evaluation should, at a minimum, analyze the resource adequacy requirements imposed by each local authority, including whether and the extent to which entities subject to those requirements have complied with them. The data must also include the amount of capacity and energy under contract or otherwise committed, and the effects of the requirements and of the preparedness of entities on the reliability of the Bulk-Power System.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

regional reliability organizations in NERC's proposed Rules of Procedure. Georgia Operators suggests adding a specific provision to the delegation agreement to impose a reporting obligation on the Regional Entity for information that is requested by NERC.

635. Finally, on another matter, International Transmission points out, with respect to the System Operator Certification Program Manual, while the certified system operator is responsible for retaining documentation of its continuing education hours for certification at section III of the manual, the training provider is not.[227] It recommends that the training provider also be required to retain comparable documentation.

NERC Reply Comments

636. NERC submits that, as required in paragraph 805 of Order No. 672, as outlined in section 800 of its proposed Rules of Procedure, it will ensure that each reliability assessment that it prepares is comprehensive and sufficient for NERC, the Regional Entities, and the Commission to fulfill their respective responsibilities. NERC will rely on data and information requested of regional reliability organizations, as well as regional reliability organization self-assessments which are to be conducted in compliance with NERC standards and the respective regional planning criteria. NERC's teams of technical experts will also conduct interviews with the regional reliability organizations. According to NERC, through this process, it will take into account regional or subregional metrics and targets as well as all reasonably credible operating conditions.

Commission Conclusion

637. With respect to PG&E's and Bonneville's concerns about the scope of the reliability and adequacy assessments prepared by the ERO, as we stated in Order No. 672, 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. We will decide the scope and content of the reliability and adequacy assessments in later proceedings where such assessments are imminent.[228] Additionally, since section 39.11(a) provides the Commission discretion to determine the types of reliability assessments the ERO shall conduct, NERC is not in the position, at this time, to provide all the details requested by PG&E and Bonneville. Although Bonneville raised additional concerns about proposed Reliability Standards that designate a load-serving entity rather than a balancing authority to forecast load and resources, this matter should be pursued in the pending proceeding in Docket No. RM06-16-000. However, when reliability and adequacy assessments are requested by the Commission to be

[227] Rules of Procedure, app. 6 at 16.

[228] Order No. 672 at P 805.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

conducted by the ERO, the expected scope and content of such reports will be made known to the relevant entities, including any flexibility necessary in regard to forecasting load and resources.

638. In this regard, it may well be helpful that adequacy assessments should include information on deficient entities or classes of entities to possibly facilitate the implementation of recommendations. However, we will not specifically require the ERO to provide these reports to local resource adequacy authorities. Order No. 672 specifically provides that reliability and adequacy 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.[229] In this way, resource adequacy authorities will have access to the reports without putting the onus on the ERO to identify all such authorities.

639. With respect to Georgia Operators' concern that certain of NERC's procedures contemplate regional reliability organizations rather than Regional Entities conducting data gathering activities, this matter has been addressed in the delegation agreement section of this order.[230]

640. We agree with International Transmission on the need for a complete record of the system operator continuing education hours. NERC is directed to revise section III of the System Operator Certification Program Manual in its compliance filing to require that the training provider is also required to maintain comparable documentation.

641. We have an additional concern, however, that NERC provides little detail overall on how it will facilitate access to the information the Commission will need to fulfill its reliability oversight and adequacy assessment roles under the statute. Access to accurate and timely information is important if both the Commission and NERC are going to be able to assess the reliability and adequacy of the Bulk-Power System in North America.[231] Although section 803 of NERC's Rules of Procedure provides that the number and type of assessments will be decided by NERC, NERC should modify its Rules of Procedure in its compliance filing to acknowledge the Commission's authority, in general, to have timely access to information and records within the time frame

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[229] *Id.* at P 807.

[230] *See* section IV.F.1.iv, *supra*.

[231] Order No. 672 at P 114.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

provided by the Commission in accordance with our regulations implementing sections 215 and 301(b) of the FPA. Confidential treatment of information submitted to the Commission, of course, may be sought pursuant to our regulations.[232]

2. NERC's General Treatment of Confidentiality

642. The Commission requires that the ERO and each Regional Entity adopt confidentiality Rules to prevent the unintended disclosure of data obtained from users, owners and operators of the Bulk-Power System.[233]

a. General

NERC Proposal

643. NERC proposes various provisions to address confidentiality needs. As noted in the Enforcement section of this order, section 408 of the Rules of Procedure is cited throughout the application as the controlling section for confidentiality issues and reporting information pertaining to compliance audits.[234] Section 408 lays out the reporting and disclosure process for a Regional Entity to report violations of Reliability Standards to NERC. Other provisions in the Rules of Procedure also address confidentiality-related matters, which we address below.

644. Section 402.9 of NERC's proposed Rules of Procedure requires that NERC and Regional Entity staff, audit team members, and committee members maintain the confidentiality of information shared during investigations, audits, drafting of reports, appeals, and closed meetings in order to maintain the integrity of the NERC enforcement program. In addition, NERC or Regional Entity staff and other enforcement program participants must adhere to a code of conduct and confidentiality agreements. Individuals not covered by a code of conduct must sign a NERC confidentiality agreement prior to participating on a committee or team, and in the event that staff, committee or audit team member violates a confidentiality Rule or the spirit of a confidentiality Rule, the violator may be subject to appropriate action by a Regional Entity or NERC.[235]

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[232] *See* 18 C.F.R. § 388.112 (2005).

[233] Order No. 672 at P 115.

[234] *See also* Rules of Procedure § 402.5, 402.9.3, 403.10.3, 403.14, 404.1, 404.3, 405, 406.3, 502.2.2.2, 506.3,710.2, and 711.4.

[235] *See also*, section 502(2.2.1) and 704(5) of the Rules of Procedure. NERC states that the confidentiality agreement for investigation of the August 2003 outage will be modified and will be used as the ERO confidentiality agreement. Appendix 8,

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

645. Sections 502.2 and 710 of the Rules of Procedure provide protections for information provided by entities in the process of being considered for the compliance registry, being functionally certified in accordance with NERC's proposed Organization Registration and Certification Manual, or as part of the process for the readiness reviews.[236] As part of the process of adjudicating an appeal of a Regional Entity's decision to require an entity to be functionally certified,[237] the NERC compliance and certification committee and the NERC board of trustees will maintain a record of the appeals process which will be treated as confidential consistent with the FERC guidelines for treatment of critical energy infrastructure information.

646. Finally, under the confidentiality provisions of the proposed *pro forma* delegation agreement, the parties agree to keep in confidence and not to copy, disclose, or distribute any confidential information without the prior written permission of the issuing party. If disclosure is required by subpoena, law, or other directive of a court, administrative agency, or arbitration panel, the party that submitted the information will be promptly notified of the request or requirement in order to enable it to seek a protective order, consult with the recipient in order to take steps to resist or narrow the scope of the request or legal process; or waive compliance, in whole or in part, with the terms of this section.[238]

Comments

647. EEI requests that the Commission ensure that the confidential provisions are consistent and are sufficient in their protection of confidential information. Entergy asks that the Commission ensure the protection of confidential data. Entergy further requests that the process for maintaining the confidentiality of information incorporate adequate due process.

648. Georgia Operators submit that portions of NERC's application and exhibits refer only to protecting critical energy infrastructure information. In its view, since NERC and

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Attachment C in the proposed Rules of Procedure.

[236] Registered entities assigned to three of the fourteen reliability functions under NERC's pending Reliability Standards (i.e., reliability coordinator, transmission operator, and balancing authority) must be certified by NERC to perform their respective functions

[237] NERC's proposed process includes language stating that the entity may request information be considered competitive or market sensitive also be withheld. NERC's proposed Organization Registration and Certification Manual, § iv (4e).

[238] *Pro Forma* Regional Delegation Agreement § 4.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the Regional Entities will have access to large amounts of other confidential information, there should be no doubt that such other information will be protected from disclosure to the full extent allowed by law.[239]

649. Georgia Operators also recommend that the Reliability Standard development process provide more protection for confidential information pertaining to an entity's appeal of any substantive or procedural action or inaction related to the development, approval, revision, reaffirmation, or withdrawal of a Reliability Standard that directly or materially affects the entity.[240]

Commission Conclusion

650. We agree with EEI and Georgia Operators on the need to ensure confidentiality where appropriate and the need to specify in the Rules of Procedure who will make such determinations. Consistent with our discussion in the enforcement section of this order, we find that NERC's proposed disclosure provisions need improvement to protect the confidential information provided by various entities. The Commission further agrees with commenters that the various provisions are vague, inconsistent or incomplete as to what information will be considered confidential and how and when confidential information will be released, and we further address the designation of confidential information below in the next part of this discussion.

651. We direct NERC to submit in its compliance filing enhanced confidentiality provisions for NERC and the Regional Entities to address commenters' concerns. Conforming changes to the *pro forma* delegation agreement should be reflected in the individually negotiated delegation agreements.

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[239] Georgia Operators observes that section 402.93 notes that section 408 identifies other information subject to confidentiality but fails to include that information with critical infrastructure information which is not to be released publicly. Georgia Operators also recommends that NERC should include a more complete description of the types of confidential information.

[240] At Level 1, the entity submits its appeal in writing to the standards process manager for review. If the entity is not satisfied with the standards process manager's finding, it may appeal to a five member Level 2 panel. The Level 2 panel's finding to either remand the issue to the Standards Committee or find against the entity will be posted publicly. Georgia Operators submit that the negative results of a Level 2 appeal board should not be posted until the entity has the opportunity to raise the matter with the Commission. Rules of Procedure § 403.12 & 408.6.2; Rules of Procedure, app. 1 at 25 - 26.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

652. The Commission rejects Georgia Operators' request that NERC revise the appeal provision of its Reliability Standard development process to include additional confidential treatment and further appeal to the Commission. Georgia Operators has not adequately explained why the appeal panel's negative finding should be treated as confidential, nor has it explained why it is necessary for the Commission to review each negative decision.

b. Designation of Confidential Information

NERC Proposal

653. Section 408.3 of NERC's Rules of Procedure states that users, owners and operators of the Bulk-Power System seeking to protect information as confidential have the obligation to demonstrate that the information qualifies for confidential treatment. Section 408.3 governs what types of information will be considered confidential and not disclosed in public information reported by NERC.[241] In addition, provision is made for information concerning a violation to be kept confidential before the report of the violation is made public. NERC's proposed *pro forma* delegation agreement in section 1(b) also provides in relevant part specification of what information may and may not be treated confidentially.[242]

Comments

654. Ameren asserts that the section 408 Rules of Procedure process for an entity to designate confidential or proprietary materials should be modified to clarify that the

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[241] Section 408.3 of the Rules of Procedure lists the following types of confidential information: (1) confidential business and market information including information that is proprietary, commercially valuable, or competitively sensitive; (2) critical energy infrastructure information as defined by *NERC Security Guidelines for the Electric Sector – Protecting Potentially Sensitive Information*; (3) personnel information that identifies or could be used to identify a specific individual, or reveals personnel, financial, medical, or other personal information; (4) audit work papers; or (5) investigative files.

[242] NERC's proposed *pro forma* delegation agreement in section 1(b) provides in relevant part that the term confidential information, ". . . includes, but is not limited to, non-price information involving power and transmission systems planning and operation, power sales and transfers, transmission transactions, and critical energy infrastructure information. Confidential Information shall not include information that, at no fault of the recipient party, is or was: (1) in the public domain or generally available or known to the public; (2) disclosed to a recipient by a third party who had a legal right to do so; or (3) independently developed by a party or known to such party prior to its disclosure hereunder."

entity initially should only need to assert a claim for confidential treatment and state the reason for its claim; but that once that request has been challenged the entity would have to make a specific showing of harm. TAPS also contends that NERC's process should place the burden of showing that information merits confidential treatment on the entity requesting confidential treatment and, in addition, provide that an entity's classification of information as confidential may be challenged.

655. Northern Indiana comments that the definition of confidential information in section 1(b) of the *pro forma* delegation agreement requires that if confidential information is identified as confidential orally, that it be "promptly" confirmed in writing. In the interest of preventing disputes over the meaning of the word "promptly," Northern Indiana proposes that the provision be revised to require written notice within three business days after the oral disclosure and identification.

656. TAPS further notes that the confidentiality provisions in the *pro forma* delegation agreement are broader than those in the Rules of Procedure and need to be made consistent. In addition, in TAPS' view, the confidentiality provisions in NERC's application should be clarified and conformed to ensure that all settlements or "other negotiated dispositions" of alleged violations are made public.

657. Ameren requests that NERC's Rules of Procedure specify who will decide disputes over confidential treatment of information and provide an opportunity for review of such a decision.

Commission Conclusion

658. We disagree with commenters who assert that NERC does not require an entity that seeks to prevent public disclosure of information to show that such information qualifies for such treatment. Section 408.3 of the proposed Rules of Procedure places the burden on users, owners and operators of the Bulk-Power System who assert that specific information is confidential. However, this should be extended to apply to all entities that seek confidential treatment of information. We also believe that the proper time for the entity to make this showing of the need for confidential treatment, in written form, is when the entity provides that information to NERC or a Regional Entity. The entity must also update the information relating to its claim of confidentiality. Thus, for example, if an entity concludes that information for which it had sought confidential treatment no longer qualifies for that treatment, the entity should so notify NERC or the relevant Regional Entity. NERC shall submit conforming modifications in its compliance filing.

659. We also share concerns about the inconsistent provisions on the types of information to be treated as confidential. NERC is directed to resolve the inconsistencies between the listings of the types of confidential information found in section 408.3 and section 1(b) of the *pro forma* delegation agreement. NERC's compliance filing should

make consistent the various sections on confidentiality[243] including the list of the types of information which may require confidential treatment, including critical energy infrastructure information and cyber-security related information.[244] Conforming changes to the *pro forma* and individually negotiated delegation agreements should also be made. Also, as we discussed in the enforcement section of this order, NERC's categorization of the particular types of information as competitively sensitive and thus confidential or otherwise exempt from public disclosure may be too broad. We direct NERC to explain in its compliance filing the basis by which NERC proposes that it and the Regional Entities would determine specific types of information as confidential or as otherwise exempt from public disclosure, including the treatment of settlements.

660. As noted by Ameren, in many instances other than the Reliability Standard development process, NERC neither identifies persons who will decide disputes over assertions of confidentiality as to specific information nor indicates whether there will be appeals or reviews of such decisions. NERC should include in its compliance filing processes under which an entity's classification of information as confidential can be challenged and the processes under which NERC and the Regional Entities would decide issues of confidentiality in specific situations.

c. Disclosure to Applicable Government Authority

NERC Proposal

661. NERC provides that information about alleged violations should be provided to the applicable government authority. NERC uses this term but does not define it in the definitions in Article 1 of the Bylaws, section 200 of the Rules of Procedure, or section 1 of the *pro form* delegation agreement.

Comments

662. Ameren and EEI state that, while sections 202.17 and 402.5 of NERC's proposed Rules of Procedure require the disclosure of "confirmed" violations, there are other provisions, for example section 408.1, which require NERC to provide information about alleged violations to the applicable governmental authority. While Ameren does not object to the Regional Entity informing NERC of a pending investigation, it requests that public disclosure be permitted only after the investigation or audit is closed and appeal rights have been exhausted or have expired.

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[243] *See, e.g.*, Rules of Procedure § 402-06,502, 506; 710-11; *Pro Forma* Regional Delegation Agreement.

[244] Order No. 672 at P 50, 511-12.

663. National Grid is concerned that the only governmental authority that has provided for confidentiality of information it receives from NERC concerning unconfirmed violations is the Commission. Therefore, National Grid asks that section 408.1 of the Rules of Procedures be modified to limit notification of unconfirmed violations to the Commission and those governmental authorities that have committed to preserve the confidentiality of such information.

Commission Conclusion

664. Consistent with the enforcement discussion of this order, we interpret the applicable governmental authority to mean the Commission in the United States. We would expect the ERO to arrange for appropriate protections of confidential information with the applicable government authorities in Canada and Mexico.

d. Breach of Confidentiality

NERC Proposal

665. Section 402.9.4 of the Rules of Procedure provides that, in the event that a staff, committee, or audit team member violates the intent of the principle or any of the confidentiality Rules the staff, committee, or audit team member and any member organization with which the individual is associated may be subject to appropriate action by the Regional Entity or NERC, including prohibiting participation in future enforcement activities. Exhibit D sections 13 and 17 of the *pro forma* delegation agreement requires a Regional Entity to structure its enforcement process with appropriate protection of due process and to comply with the confidentiality requirements contained in the delegation agreement and other confidential agreements required by NERC.

Comments

666. Georgia Operators requests that entities that report to, or are audited or investigated by NERC or a Regional Entity should have the right to seek injunctive relief in case of a breach or threatened breach of confidentiality by NERC, the Regional Entity, or their respective staff, committees or volunteers.

667. National Grid asks that NERC clarify the scope of available remedies in the event that information is inappropriately leaked. National Grid contends that section 402.9.4 of the Rules of Procedure is too vague to provide assurance that participants in the investigation process will not disclose inappropriate information to the public. National Grid submits that, at a minimum, NERC should revise section 402.9.4 to make clear that whatever administrative remedy NERC or a Regional Entity adopts for a breach of confidentiality will not preclude any lawsuit or criminal prosecution that might be warranted as a result of the damage caused by inappropriate disclosure of information to

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

the public. Also, the *pro forma* delegation agreement should be revised to incorporate an explicit requirement that the Regional Entity enforcement programs adopt procedures to preserve confidentiality during the course of investigations.

Commission Conclusion

668. We deny Georgia Operators' request that the Commission direct NERC to revise section 402.9.4 of the Rules of Procedure to make clear that whatever administrative remedy NERC or a Regional Entity adopts for a breach of confidentiality will not preclude any lawsuit, criminal prosecution or injunctive relief. An entity's right to seek injunctive relief in the case of a breach of confidentiality by NERC, a Regional Entity, or their respective staff, committees or volunteers is a matter for the courts and not this Commission. However, we direct NERC to clarify in its compliance filing what recourse is available to entities who are threatened with breach of confidentiality or whose confidentiality is breached. In addition, we direct NERC to clarify that the Regional Entity is bound to preserve confidentiality during the course of investigations and to revise the *pro forma* and each individually negotiated delegation agreement accordingly. Further, we direct NERC to clarify in its compliance filing the scope of available remedies in the event that information is inappropriately leaked.

H. ERO and Regional Entity Rules

669. Section 39.10(a) of our regulations provides that the ERO shall file for Commission approval any proposed ERO Rule or Rule change. A Regional Entity shall submit any Regional Entity Rule or Rule change to the ERO for approval, and if approved by the ERO, the ERO shall submit such for Commission approval.[245]

NERC Proposal

670. NERC's proposed Rules of Procedure would require that any request to amend or repeal the Rules of Procedure must be submitted by: (1) any ten members representing at least three membership segments; (2) the member representatives committee; (3) a standing committee whose charge is relevant to the Rule; or (4) an officer of the ERO. The Rules of Procedure would further require public notice and opportunity for comment. The NERC board would then vote on the proposed Rule change after considering the input of the member representatives committee, other ERO committees affected by the Rule change, and other stakeholders as appropriate. If approved, NERC would submit the Rule change to the Commission.

[245] Order No. 672 at P 791, 796

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

671. No comments were filed beyond those we address in the section on Amendments to the NERC Rules in the delegation agreement section of this order.

Commission Conclusion

672. Except for our determination in the delegation agreement section of this order, we find that NERC's application meets the requirements of our regulation with regard to the process of changing ERO Rules and Regional Entity Rules. NERC's process is fair and open and requires Commission approval before any Rule change can take effect.

I. Compliance Registry

673. Section 39.2 of our regulations requires that each user, owner and operator of the Bulk-Power System must register with the ERO and the Regional Entity for each region within which it uses, owns or operates Bulk-Power System facilities, in such manner as prescribed by the Rules of the ERO and each applicable Regional Entity. If during the registration process there remains a question whether a specific user or other entity is subject to this Rule, the entity or the ERO may request the Commission's guidance on the matter.

1. General

NERC's Proposal

674. NERC proposes a registration process for users, owners and operators of the Bulk-Power System that are subject to Commission-approved Reliability Standards.[246] NERC's would identify and register entities based of fourteen categories.[247] An entity listed in the registry will be responsible for knowing the content of and complying with the applicable Reliability Standards.

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[246] NERC's compliance registry process is addressed at Section 500 of NERC's proposed Rules of Procedure (Organization Registration and Compliance), and the Organization and Certification Registration Manual at Appendix 5 to the Rules of Procedure.

[247] The functional categories include: (1) reliability coordinator, (2) balancing authority, (3) planning authority, (4) transmission planner, (5) transmission operator, (6) transmission service provider, (7) transmission owner, (8) resource planner, (9) distribution provider, (10) generator owner, (11) generator operator, (12) load-serving entity, (13) purchasing-selling entity, and (14) compliance monitor.

675. NERC claims that this compliance registry process provides an appropriate level of specificity in identifying users, owners and operators of the Bulk-Power System and ensures that an entity which is subject to a Reliability Standard will know its status in advance and have an opportunity to challenge that determination.

676. A reliability coordinator, transmission operator or balancing authority must be certified by NERC to perform its functions. NERC states that a compliance and certification committee approves the certification of the functional entities. This typically takes three to nine months. NERC's goal is to certify all reliability coordinators, transmission operators and balancing authorities within the NERC footprint by January 1, 2009. An independent audit of the certification program is required at least every three years to evaluate the success and effectiveness of the program. One function (compliance monitor) pertains to the role of the regional reliability organizations specified in the pending Reliability Standards.

677. NERC states that it may delegate registration and certification to a Regional Entity; however, NERC will have the final authority in all matters constituting the compliance registration and functional certification of an entity. Under NERC's registry program, each Regional Entity must maintain a fair, independent, nondiscriminatory appeals process.

678. A joint action agency or similar organization (e.g., a generation and transmission cooperative) may register in lieu of each of its members, provided that it accepts the reliability functions performed for its members. An entity's listing in the compliance registry will not cause it to become a member of NERC, a Regional Entity or a regional reliability organization.

679. NERC indicates that it began to implement its compliance registration process in January 2006. Once it is certified as the ERO, NERC intends to send each user, owner and operator of the Bulk-Power System a notice as to its compliance registry status. An entity that disagrees with the determination may submit a challenge in writing to NERC and, if still not satisfied, may lodge an appeal with the Commission.

680. NERC will maintain a list of all registered users, owners and operators of the Bulk-Power System on its website. A registrant will be required to notify NERC and the corresponding Regional Entity of any change in ownership, corporate structure, or similar matters that affect the entity's responsibilities with respect to the Reliability Standards. NERC will update the compliance registry to reflect such changes. A failure to notify NERC of a change in status will not relieve an entity from any responsibility to comply with the Reliability Standards or shield it from any penalties or sanctions for noncompliance.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

681. Bonneville and others contend that NERC's compliance registry process needs more clarity and consistency. EEI asserts that the registration Rules must be clear and thorough so that all entities potentially required to comply with a Reliability Standard must register. Georgia Operators, noting that there seems to be several lists of functional entities that NERC has relied upon, states that there should be only one such list. ELCON contends that some registration criteria use vague language, for example, "[a] customer… would not in general be considered a user..." or "[a]n entity … will generally be considered to be a user … unless the entity's actions or facilities have… no material impact on the Bulk-Power System."[248] ELCON asserts that specific criteria are needed to assure that NERC and regional Reliability Standards and compliance programs apply only to (1) those entities with direct, material and measurable impacts on the Bulk-Power System and (2) those users that have been clearly designated as a responsible entity as opposed to the public utility that would normally be expected to fulfill that responsibility.[249]

682. NRECA concurs in NERC's use of the "material impact" test but, is concerned about the potential for inconsistent application of this test across Regional Entities. EEI calls for similar entities located in different regions to be treated in a like manner, and submits that NERC must provide clear direction to the Regional Entities to follow a consistent approach.

683. ELCON complains that, even though Order No. 672 deferred decision on the issue of the nature of users of the Bulk-Power System until consideration of the proposed Reliability Standards, NERC is proceeding with the registry process without having adequately defined the scope of the affected facilities. National Grid points out that, while NERC's glossary references "bulk electric system," its Bylaws, Rules of Procedure, and Organization Registration and Certification Manual appear to incorporate inconsistent variations of the statutory definition of "Bulk-Power System." National Grid recommends that the Commission require refiling of these documents to include a single, precise and workable definition of "Bulk-Power System."

684. NARUC contends that, while NERC cites its glossary of terms as the basis for the definition of bulk electric system, NERC omitted that in practice such term is further defined by the regional reliability organization. The New York Commission and NARUC state that both NPCC and NERC have historically regarded several 115 kV and 138 kV facilities as not being part of the bulk electric system. Similarly, several facilities above 100kV in SoCal Edison's territory are considered local distribution facilities and

[248] Rules of Procedure §§ 501.1.2.4, 501.1.2.5.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

fall within the state's jurisdiction. They assert that the regional reliability organization or its successor organization should continue to maintain the separate definition of the term bulk electric system to determine which facilities perform bulk system functions because regional reliability organizations have the most familiarity with the local systems and are in the best position to make such determinations.

685. Some commenters express concern about the joint action agency registration provision at section 501.1.2.7 of NERC's Rules of Procedure, which permits an entity such as a generation and transmission cooperative to register on behalf of its smaller members. Georgia Operators asks NERC to explain what it means for a joint action agency to register on behalf of its members "by accepting the reliability functions … of that entity's members." It is concerned about the risk that if a small member of a joint action agency were to commit a violation, NERC might calculate the penalty based not on the size of that member's load but on the aggregate size of all of the joint action agency's load. APPA submits that this provision will only work where the Reliability Standard compliance obligations of the small members are well-defined and the joint action agency is able to negotiate agreements to assume their compliance obligations. APPA further notes that, since joint action agencies and municipal electric systems are creatures of state law, a contractual arrangement that is feasible in one jurisdiction may not be allowed in another. Georgia Operators further suggests that the reference to "generation and transmission cooperative" be replaced with the more general term "cooperative" to allow a distribution cooperative to register.

686. Commenters raise some other registration matters. ELCON submits that the provision that allows anyone to nominate an entity to NERC's compliance registry may lead to frivolous nominations that will require costly rebuttals, because there is no burden of proof requirement. While APPA observes that the mere inclusion of an entity on the compliance registry does not determine the entity's compliance obligation because that obligation is established through the specific functional scope and applicability of each of the Commission-approved Reliability Standards, ELCON recommends that the Rules of Procedure be modified to more explicitly state that all entities on the registry are not necessarily required to comply with all Reliability Standards.

687. SoCal Edison suggests that NERC's Organization Registration and Certification Manual were to be cross-referenced with the corresponding section of NERC's proposed Rules of Procedure on registration. Finally, SoCal Edison suggests that providing opportunity for public input on the completeness of the compliance registry would be helpful and in this regard asks that the Commission require NERC to update the compliance registry on its website at least once a month.[250]

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[250] In this regard, SoCal Edison would add a new section in 501.3 to NERC's proposed Rules of Procedure: "The compliance registry will be updated at least monthly

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC Reply Comments

688. NERC notes that commenters requested clarification from either NERC or the Commission regarding the term "Bulk-Power System." NERC notes the definition in section 215, and states that its proposed Bylaws and Rules of Procedure use the statutory definition, which is not exactly the same as the definition of "bulk electric system" in the NERC Glossary of Terms used in Reliability Standards. NERC says the NERC Planning Committee and Operating Committee are reviewing these definitions, and it expects to provide suggestions regarding use of the terms "Bulk-Power System" and "bulk electric system" in its response to Staff's preliminary assessment of the Reliability Standards. NERC notes difficulties in determining the scope of the term "Bulk-Power System" and says it does not believe it can provide further clarification in its application. NERC notes that, as a general proposition, it does not believe it is appropriate for regional reliability organizations to define what elements are in or not in the "Bulk-Power System."

Commission Conclusion

689. Section 39.2(c) of our regulations directs each user, owner and operator of the Bulk-Power System to register with the ERO and each applicable Regional Entity in such manner prescribed by the ERO and each applicable Regional Entity. We find that NERC's proposed registration process and corresponding Rules of Procedure provide a reasonable means to implement this Order No. 672 requirement. Further, NERC's functional approach provides a reasonable means to ensure that the proper entities are registered and that each knows which Commission-approved Reliability Standard(s) are applicable to it. The proposed notice and appeals provisions allow for adequate due process. Accordingly, we accept NERC's proposed registration process, subject to NERC providing specific revisions and clarifications as discussed below.

690. We agree with EEI and NRECA that similar entities located in different regions should be treated in a like manner and NERC should take steps to incorporate this into its compliance registry Rules and/or delegation agreements. We agree with SoCal Edison's suggestion that the Organization and Certification Manual and the Rules of Procedure should be cross-referenced. Further, regarding Georgia Operators' comment, we find that NERC should provide a single, accurate list of functional entities. Consistent with SoCal Edison's comment, we direct NERC to update the compliance registry on its website at least once a month.

691. We share the concerns of many commenters regarding inconsistency or lack of clarity in NERC's registration process that could lead to uncertainty with respect to which

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and posted on NERC's website for public access."

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

entities should be registered. However, these concerns, in large part, are not due to deficiencies in NERC's certification application but, rather, relate to our deferral in Order No. 672 to adopt a definition of certain terms that have jurisdictional implications.

692. In particular, until we consider the scope and applicability of any approved Reliability Standard as it applies to users, owners or operators of the Bulk-Power System, and we interpret and apply the Order No. 672 definition of the "Bulk-Power System," as necessary, in the proceeding that addresses NERC's proposed Reliability Standards (Docket No. RM06-16-000), the matters of inconsistencies and clarity cannot be fully resolved with regard to NERC's proposed compliance registry process. Likewise, the complete registration of "users" of the Bulk-Power System hinges upon the context and use of the term in a relevant Reliability Standard, and will be addressed by the Commission in Docket No. RM06-16-000. Once we have considered and approved a Reliability Standard and its scope and applicability, NERC's compliance registry should track our determination. The registry will be considered informative but not dispositive of who is subject to the Commission jurisdiction for reliability purposes as this is a matter ultimately for the Commission to decide. Accordingly, we find that NERC and the Regional Entities should not consider the list of registrants as final until the Commission has first considered the types of entities to which a particular Commission-approved Reliability Standard may apply.[251]

693. We disagree with EEI's concern about the lack of a legal basis for NERC to additionally include Regional Entities, regional reliability organizations and NERC itself on the compliance registry. Although pursuant to Order No. 672 a proposed Reliability Standard may impose a requirement on any user, owner or operator of the Bulk-Power System, but not on others,[252] Order No. 672 clearly contemplates a registry that serves to help inform the Commission of the identity of all entities subject to the Commission's reliability jurisdiction, the Commission's regulations, and applicable ERO and Regional Entity Rules.[253] Thus, there is no basis to reject NERC's proposal for NERC and the Regional Entities to be on the compliance registry. The Commission notes that it is not necessary to identify NERC and each Regional Entity on the compliance registry because they will be identified through this order certifying NERC as the ERO, and subsequent orders approving the individual executed delegation agreements. To the extent that the

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[251] Order No. 672 at P 98-100.

[252] *Id.* at P 321-22.

[253] *Id.* at P 117.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Commission determines in the Docket No. RM06-16-000 proceeding that a regional reliability organization has a role to play with respect to the Commission approved Reliability Standards, then it too should be listed on the compliance registry.

694. However, we do not share ELCON's concern that, because any person may be able to make a frivolous recommendation to NERC that an organization be added to the compliance registry, this will necessarily lead to a costly rebuttal process. We expect that NERC or a Regional Entity would consider a third-party nomination only when it is accompanied by supporting reasons, as required by NERC's Rules of Procedure.

2. Concerns about Functional Categories

NERC's Proposal

695. As noted above, NERC's compliance registry will set forth the identity of those organizations responsible for meeting fourteen primary functions under the Reliability Standards. NERC states that these are functions that are required to secure the reliable operation of the electric grid, as identified in NERC's Reliability Standards. NERC asserts that, for all geographical or electrical areas of the Bulk-Power System, the registration process will ensure that (1) no areas are lacking any entities to perform the duties and tasks identified in and required by the Reliability Standards to the fullest extent practical, and (2) there is no duplication of such coverage or of required oversight of such coverage.

696. NERC contends that its functional identification process will: (1) ensure that all areas are under the oversight of one and only one reliability coordinator; (2) ensure that all balancing authorities and transmission operator entities are under the responsibility of one and only one reliability coordinator; (3) ensure that all transmission elements of the Bulk-Power System are the responsibility and under the control of one and only one transmission planner, planning authority, and transmission operator; and (4) ensure that all loads and generators are under the responsibility and control of one balancing authority.[254]

[254] NERC indicates that some organizations perform the listed functions (e.g., balancing authority, transmission operator) over areas that transcend the footprints of more than one reliability coordinator. Such organizations will have multiple registrations, with each such registration corresponding to that portion of the organization's overall area that is within the footprint of a particular reliability coordinator.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Comments

697. PG&E opposes NERC's proposed Rules of Procedure which provide that NERC or the Regional Entity verify that each transmission element of the Bulk-Power System falls under the authority and control of one and only one transmission planner and transmission owner. PG&E asserts that this is neither necessary nor desirable, as a number of existing transmission facilities share responsibility for planning and ownership among multiple owners Similarly, National Grid points out that NERC's functional entities do not necessarily align with the structures that National Grid has created in New York and New England where the owners, RTOs, and ISOs share numerous planning functions in accordance with Commission approved operating agreements, nor is NERC's notion that there should be a single entity with planning responsibility consistent with the terms of these comprehensive agreements.

698. Bonneville contends that, because the complexities of electric operations do not always neatly fit into the list of functional elements NERC has identified and because the boundary between the functions is not always clear, it agrees with NERC that the registration process will have to remain flexible to accommodate changing circumstances over time.

Commission Conclusion

699. PG&E's, Bonneville's and National Grid's concerns about the need for NERC's functional categories to recognize shared functions, multiple ownership arrangements and Commission approved operating agreements cannot be resolved in the instant ERO certification proceeding, but must be considered when the Commission approves a Reliability Standard that implicates any of these matters in Docket No. RM06-16-000.

3. Exemptions from Registration

NERC's Proposal

700. NERC states that, in determining whether a particular user, owner or operator of the Bulk-Power System should register, it will use the following criteria. Owners and operators of the Bulk-Power System will generally be included in the registry. All generation resources, transmission lines, interconnections with neighboring systems, and associated equipment, generally operated at voltages at 100 kV or higher would be considered part of Bulk-Power System. Radial transmission facilities serving only load with one transmission source, without more, would not be considered part of Bulk-Power System.

701. An entity 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 system that are part of Bulk-Power System

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

would not, in general, be registered as a user of the Bulk-Power System. Or, where an entity directly connected to the Bulk-Power System or selling, purchasing, or transmitting electric energy over the Bulk-Power System is determined to have no material impact on the Bulk-Power System, it would not be registered as a user of the Bulk-Power System.

702. NERC explains that it will consider other factors , as well, such as the consequence of an entity's action or inaction on the reliability of the Bulk-Power System (e.g., being part of a special protection system) in making a determination whether that entity is required to register as a user of the Bulk-Power System.

Comments

703. APPA and NRECA support NERC's proposal to limit registration to users, owners and operators whose actions or inactions could have a material impact on the Bulk-Power System. In APPA's view, requiring small entities to register will subject them to the mandatory Reliability Standards, thus imposing new burdens and costs not only on such small entities but also on the NERC and the Regional Entities[255] and possibly on the Commission itself because the Regulatory Flexibility Act of 1980 requires the Commission to conduct an analysis of the impact of all of its proposed regulations on certain small entities.[256]

704. California Cogeneration asks the Commission to adopt a 20 MW threshold to exempt small generators from being a user of the Bulk-Power System. APPA and MEAG also recommend a minimum threshold for load below which small entities would be exempt from the registration requirement. In the case of a distribution system that does not fit the size threshold for exemption, MEAG asks the Commission to require NERC to demonstrate on a case-by-case basis how the distribution system impacts the reliability of the Bulk-Power System, subject to appeal at the Commission.

705. MEAG also argues that, since section 215 of the FPA prohibits "facilities used in the local distribution of electric energy" being subjected to mandatory reliability requirements, distribution providers should not be required to register. Furthermore, since MEAG's distribution member systems are not directly connected to the Bulk-Power System, it would be inappropriate to require them to register as users. MEAG contends

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[255] APPA contends that hundreds of its small public power systems may have to register under NERC's rules either as a Distribution Provider, Load-Serving Entity, or Generator Owner. Of the 1900 public power systems in the 48 lower states, about 1400 are very small with a peak load of less than 25 MW, and about 600 own total generating capacity of less than 20 MW.

[256] According to APPA, 98 percent of public power utilities are small utilities under the Small Business Administration (SBA) threshold of 4 million MWhs.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

that, while it is mindful that the Commission will address an exemption for distribution-only entities from the mandatory Reliability Standards in Docket No. RM06-16-000, NERC's proposed registry process presupposes and predetermines that distribution only members are subject to these standards. Thus, NERC's request for ERO status should be stayed subject to the resolution of these matters in Docket No. RM06-16-000.

706. Some commenters state that NERC's compliance registry Rules are overly broad in their applicability to retail loads. SMA seeks clarification that, as a general rule, a retail load connected at a transmission level voltage will not be considered a user whether or not it is directly interconnected with the Bulk-Power System, and that a retail load that is must have a material impact on the reliability of the Bulk-Power System. Similarly, MEAG argues that its members are wholesale customers that, in effect, act like large retail customers and therefore the Reliability Standards should not apply to them.

707. ELCON asserts that, while an industrial Facilities served exclusively by Network Service under an Open Access Transmission Tariff may be subject to the NERC registration requirement; if the industrial facility is served under a state jurisdictional tariff or contract, it should not have to register with the ERO as a user of the Bulk-Power System. In SMA's view, in most instances, the load-serving entity, not the retail load, should be responsible for adherence to a Reliability Standard. California Cogeneration seeks clarification as to whether a Qualifying Facility that serves industrial load, receives standby power, makes sales to a utility company pursuant to the Public Utilities Regulatory Polices Act of 1978 (PURPA), or makes *de minimis* sales should not be considered a user of the Bulk-Power System because these activities have no material impact on the Bulk-Power System.

708. APPA submits that there is no need to register distribution entities not directly interconnected to the Bulk-Power System. MEAG further asks that distribution-only entities below a certain size be exempt because their impact on the Bulk-Power System is minimal. Similarly, ELCON submits that entities should not be subject to registration if they do not own/operate facilities that are directly connected and control the operation of the Bulk-Power System or directly sell, purchase or transport power over the Bulk-Power System. ELCON also argues that the mere fact that many industrial users are served at high voltages or are connected through substations that are classified as transmission for record-keeping purposes should not be used by the ERO as a pretext to require them to register as a user.

709. EEI, on the other hand, opposes any exceptions to the registration requirement based on the size or nature of an entity.

Commission Conclusion

710. We will not require NERC to adopt any additional registration exemptions in this proceeding. As we indicated above, any type of threshold for registration of an entity is

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

first a function of each Commission-approved Reliability Standard and its scope and applicability as determined by the Commission.[257] Thus, as discussed above, final determinations of users, owners and operators who must register are Reliability Standard-specific decisions beyond the scope of this ERO certification proceeding. The final registration process cannot be completed until the Commission determines the scope and applicability of particular Reliability Standards that it may approve in Docket No. RM06-16-000 or future proceedings involving proposed Reliability Standards.[258]

4. Implementation of Registration Process

NERC Proposal

711. According to its overall transition plan, NERC's preliminary compliance registry implementation recognizes that NERC intends to test its proposed sanction guidelines during 2006-2007 under two trial programs, without collecting penalties, to identify any improvements necessary prior to the application of financial penalties. A report on the effectiveness of the sanction guidelines will be submitted to the Commission and Canadian authorities by May 31, 2007. NERC contends that this will also allow sufficient notice to registered users, owners and operators of the Bulk-Power System that will be subject to penalties beginning July 1, 2007, and have a positive impact on performance.

Comments

712. Some commenters recommend delay in the implementation of NERC's registration process that is already underway. National Grid submits that the Commission should acknowledge that any of the March 15, 2006 registrations were intended for NERC's planning purposes only and should rule that those registrations will not be treated as final or binding on any entity. SoCal Edison maintains that NERC and the Regional Entities do not have enough information to begin compiling a comprehensive list of users, owners, and operators until greater specificity is provided both in the applicability section of each Reliability Standard and the selection criteria for registration under section 501 of NERC's proposed Rules of Procedure.

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[257] Order No. 672 at P 98-101.

[258] Order No. 672 did recognize 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. *Id.* at P 98.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

713. ELCON suggests that once NERC is certified as the ERO, it should then proceed to develop the registration criteria in a fair, open and inclusive manner, focusing on entities engaged in activities that have a direct, material and measurable impact on the Bulk-Power System. WECC recommends that NERC be directed to extend the six month trial notice period to one year. WECC notes that some Reliability Standards are annual standards for which compliance cannot be evaluated in only six months. In addition, more time is needed to locate, notify, and educate the new entities that should be registered and test, finalize and deploy some of the key elements of NERC's functional model.

Commission Conclusion

714. We agree with WECC that identifying all the users, owners and operators on the compliance registry by January 1, 2007 seems optimistic. It may take more time to register all the entities that will fall under the mandatory Reliability Standards in an orderly fashion once the scope and applicability of each Reliability Standard is approved by the Commission. However, most or all of the owners and operators of the grid, at whom most of the more important standards for preventing major blackouts are aimed, can be identified quickly, and we urge NERC and the Regional Entities to be as aggressive as practical in completing the preliminary nonbinding compliance registry prior to the Commission's approval of any of the proposed Reliability Standards submitted in Docket No. RM06-16-000. This preliminary registry will be helpful in completing the final registrations once we have approved Reliability Standards.

J. ERO and Regional Entity Performance Assessment

715. Section 39.3(c) of our regulations provides that an ERO must 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 ERO and issue an order finding that the ERO meets the statutory and regulatory criteria or directing the ERO to come into compliance with or improve its compliance with the requirements of Order No. 672,[259] or directing the ERO

[259] *Id.* at P 191, 754-55. In Order No. 672, we noted that a Commission compliance audit of the ERO is not the same as our performance assessment of the ERO. The compliance audit is a means for the Commission frequently to ensure that the ERO is doing its job and examines its ongoing compliance with the statutory and regulatory criteria to qualify as an ERO and also its actual enforcement of Reliability Standards. While the compliance audit focuses on examining any deficiencies in ERO compliance, especially for investigations and penalty setting, the periodic performance assessment looks beyond the ERO's ongoing compliance with the statutory and regulatory criteria and consists of an examination of how well the ERO is carrying out all its

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

or Regional Entity to comply or improve compliance with the statutory and regulatory criteria for the ERO.[260]

716. Section 39.3(c)(1)(iii) of the Commission's regulations 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.

NERC Proposal

717. The proposed *pro forma* delegation agreement requires NERC to review the Regional Entity's enforcement program as often as it deems necessary, but no less than every three years in compliance with section 39.3(c) of the Commission's regulations. The *pro forma* delegation agreement requires NERC's review ensure that the Regional Entity's enforcement program: (1) meets all applicable legal requirements; (2) promotes consistent interpretations of the Reliability Standards; and (3) provides for comparable levels of sanctions and penalties for violations of the Reliability Standards which constitute comparable levels of threat to the Bulk-Power System.[261] In addition, the *pro forma* delegation agreement requires that the review ensure that the actual practices of the Regional Entity reflect the requirements of the enforcement program. Further, after NERC's review, the *pro forma* delegation agreement requires the Regional Entity to modify its enforcement program to comply with NERC's directives.[262] Finally, the *pro*

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responsibilities, including the ERO's compliance investigations, penalty-setting responsibilities, its development of Reliability Standards, its ERO Rules and its relationships with the Regional Entities.

[260] *Id.* at P 754-55.

[261] *Pro Forma Regional Delegation Agreement* § 6(h).

[262] *Id.* § 6(i).

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

forma delegation agreement requires NERC conduct a review with the Regional Entities which provides for the exchange of information on practices, experiences, and lessons learned in the implementation of the enforcement programs.[263]

Comments

718. Allegheny asserts that NERC should review Regional Entity compliance programs more frequently than every three years. It maintains that promoting consistent interpretations of Reliability Standards across the regions and comparable levels of sanctions and penalties to violations of Reliability Standards is extremely important and that a triennial audit program is not sufficient to accomplish this goal and will permit the development of significant regional differences, thereby requiring the expenditure of greater resources to bring about uniformity once the differences have been identified. Allegheny requests that the Commission require NERC to conduct such audits on at least an annual basis.

Commission Conclusion

719. The Commission's regulations require the ERO to conduct its self-assessment, including an assessment of each Regional Entity, after three years and every five years thereafter. Therefore, we see no need to require NERC to conduct audits of Regional Entities more frequently.

K. Definitions

720. While we defined several relevant terms in Order No. 672 as used in Part 39 of the Commission's regulations and the statute, we permitted an ERO candidate to propose additional terms as part of its certification application or as part of a proposed Reliability Standard.[264]

NERC Proposal

721. NERC adopts some of the definitions from the Final Rule and adds definitions for about 50 new terms in its proposed Bylaws, Rules of Procedure, *pro forma* regional delegation agreement, organization registration and certification manual, and system

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[263] *Id.* § 6(j).

[264] *Id.* at P 96-99. Among the terms commenters proposed which we declined to define in Order No. 672: "competition," "physical security standard," and "potential violation." The Commission provided guidance on the remaining terms: "regional Reliability Standard," "regional variance," "user of the Bulk-Power System" and "end user."

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

operator certification program manual. In addition, NERC incorporates by reference definitions for certain of the terms as defined in two separate documents: NERC's Glossary of Terms and the Glossary of Terms used in Reliability Standards.

Comments

722. Bonneville states that NERC's Bylaws provide that "[t]echnical terms not defined in these Bylaws shall have the definitions set forth in the Federal Power Act, Part 39 of the regulations of the Commission, or the Glossary of Terms Used in Reliability Standards."[265] This section does not specify which definition controls if a term that is not defined in the Bylaws is defined in more than one source. NERC should resolve this ambiguity by modifying this section to provide that the order of precedence is the FPA; Part 39 of the Commission's regulations; and the Glossary of Terms Used in Reliability Standards.

723. In addition, Bonneville states that the term "system operator" is defined differently in the Bylaws (Exhibit B, Article I §1.l) and in the Rules of Procedure (Exhibit C, Rules of Procedure § 202.16). The entities listed under the definition of System Operator in the Bylaws are a subset of the entities listed under the definition in the Rules of Procedure. Bonneville asks that the definition in the Bylaws be replaced by the one in the Rules of Procedures, which more accurately reflects the meaning of this term.

724. PG&E states that NERC uses two terms "load-serving entities" (lower-case) and "Load-Serving Entities" (capitalized) as having two distinct meanings, which will lead to confusion and misunderstanding. The former is defined as an entity that "secures energy and transmission service (and related Interconnected Operations Services) to serve the electrical demand and energy requirements of its end use customers."[266] The latter is used to describe segment three of the registered ballot body and includes entities serving end-use customers under a regulated tariff, a contract governed by a regulatory tariff, or other legal obligation to serve, but excludes entities such as transmission dependant utilities as well as brokers, aggregators and marketers that also serve end-use customers.

725. According to PG&E, industry generally considers all providers of energy services, including transmission dependent utilities, energy brokers, aggregators, and marketers within the definition of "load-serving entities." The two terms - "load-serving entities" and "Load-Serving Entities" – should be consistently used. PG&E asserts that NERC's broad interpretation of the term "load-serving entities" under funding, but limited meaning when describing voting segment for "Load-Serving Entities" is inappropriate.

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[265] Bylaws art. I, § 3.

[266] Transmittal Letter at 44 & n.16.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

NERC Reply Comments

726. In its reply, NERC proposes to delete the definition of "system operator" in the proposed Bylaws and Rules of Procedure, saying the term is not otherwise used in either document or in the proposed Reliability Standards.

Commission Conclusion

727. We direct NERC to adopt definitions of the terms defined in Order No. 672 throughout its documents in its compliance filing. Any other definition of those terms is not acceptable.

728. The Commission accepts NERC's proposal to delete the definition of "system operator" in the proposed Bylaws and Rules of Procedure and requires NERC to make this change in its compliance filing.

729. NERC uses the term "Load-Serving Entities" (capitalized) as a label to refer to segment 3 of the registered ballot body within its Reliability Standard Development Procedure (Appendix 1). NERC uses "load-serving entities" (lower-case) to refer to entities that will fund the ERO. Although the former is used strictly as a label and the latter with its own definition, there is a potential for confusion. We direct NERC to take necessary steps to remove the potential for confusion in its compliance filing.

The Commission orders:

(A) NERC's application to be certified as the single Electric Reliability Organization is hereby granted, as modified, as discussed in the body of this order.

(B) NERC is directed to submit a compliance filing and additional materials, as discussed in the body of this order, within 90 days of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Appendix A
Intervenors and Commentors

Comments

Abbreviation	**Commenter**
Alcoa	Alcoa, Inc. and Alcoa Power Generating Company
Allegheny	Allegheny Power and Allegheny Energy Supply Company, LLC
Ameren	Ameren Services Company
APPA	American Public Power Association
Bonneville	Bonneville Power Agency
California Cogeneration	Cogeneration Association of California
California Commission	Public Utilities Commission of the State of California
California IOUs	California Investor Owned Utilities and the California ISO
California ISO	California Independent System Operator Corporation
ConEd	Consolidated Edison of New York, Inc.
Constellation	BG&E/Constellation
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
Entergy	Entergy Services, Inc.
EPSA	Electric Power Supply Association
Exelon	Exelon Corporation

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

FirstEnergy	FirstEnergy Service Company
FRCC	Florida Reliability Coordinating Council
Georgia Operators	Georgia System Operations Corp.
International Transmission	International Transmission Company
ISO/RTO Council	The ISO/RTO Council
MEAG	MEAG
MRO	Midwest Reliability Organization
NARUC	National Association of Regulatory Utility Commissioners
National Grid	National Grid USA
New York Commission	State of New York Department of Public Service
Northern Indiana	Northern Indiana Public Service
NPCC	Northeast Power Coordinating Council
NRECA	National Rural Electric Cooperative Association
PG&E	Pacific Gas & Electric Company
Progress Energy	Progress Energy, Inc.
ReliabilityFirst	ReliabilityFirst Corp.
Santee Cooper	South Carolina Public Service Authority
SERC	Southeastern Electric Reliability Council, Inc.
SMA	Steel Manufacturers Association

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

SoCal Edison	Southern California Edison Company
Southern	Southern Company Services, Inc.
SPP	Southwest Power Pool
TANC	Transmission Agency of Northern California
TAPS	Transmission Access Policy Study Group
WECC	Western Electricity Coordinating Council
Wisconsin Electric	Wisconsin Electric Power Company

Interventions

American Transmission Company, LLC
American Municipal Power – Ohio, Inc.
Calpine
City of Santa Clara dba Silicon Valley Power, City of Redding, and M-S-R Public Power Agency
Consumers Energy Co.
Duke Energy Corp.
Georgia Transmission Corp.
Illinois Commerce Commission
Indiana Office of Utility Consumers Counsel
Indianapolis Power & Light Company
Maryland Office of People's Counsel
Michigan Electric Transmission Company, LLC, jointly
MidAmerican Energy Company & Pacificorp
Modesto Irrigation District
Northern California Power Agency
New York Independent System Operator, Inc.
Northeast Utilities Service Company
New York State Reliability Council
Oglethorpe Power Corp.
Old Dominion Electric Cooperative
Public Service Electric & Gas Company, PSEG Energy Resources & Trade LLC, PSEG Power LLC

20060720-3060 Issued by FERC OSEC 07/20/2006 in Docket#: RR06-1-000

Select Energy, Inc.
Seminole Electric Cooperative, Inc.
Sacramento Municipal Utiltiy District
Tennessee Valley Authority
Valero Energy Corp.
Western Interconnection Regional Advisory Body

Interventions Out of Time

Mirant Corp.
Arkansas Electric Cooperative Association
New York Power Authority