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May 8, 2006

**Via Electronic Filing**

Honorable Magalie Roman Salas  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, DC 20426

**Re: North American Electric Reliability Council and North American  
Electric Reliability Corporation; Docket No. RR06-1-000**

Dear Ms. Salas:

Attached for filing in the referenced docket are the Comments of the ISO/RTO  
Council.

If there are any questions concerning this filing, please call me at (202) 661-2212.

Very truly yours,

/s/

Daniel R. Simon  
Counsel for  
ISO New England Inc.

Enclosure

**UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION**

North American Electric Reliability Council            )  
and North American Electric Reliability                )  
Corporation    )       Docket No. RR06-1-000

**COMMENTS OF THE ISO/RTO COUNCIL**

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May 4, 2006

## COMMENTS OF THE ISO/RTO COUNCIL

The ISO/RTO Council (“IRC”)<sup>1</sup> respectfully submits the following comments<sup>2</sup> on the Request of the North American Electric Reliability Council and North American Electric Reliability Corporation for Certification as the Electric Reliability Organization (“Application”) submitted to the Federal Energy Regulatory Commission (“Commission”) pursuant to Section 215 of the Federal Power Act<sup>3</sup> and 18 C.F.R. Part 39.<sup>4</sup>

### I. OVERVIEW

The IRC supports the Commission certifying the NERC Corporation as the ERO. However, the Commission must condition its certification of the NERC Corporation as the ERO and otherwise address structural issues for the following reasons:

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<sup>1</sup> The nine functioning Independent System Operators (“ISOs”) and Regional Transmission Organizations (“RTOs”) in North America formed the IRC in April 2003. The IRC’s mission is to work collaboratively to develop effective processes, tools, and standard methods for improving competitive electricity markets across North America. In fulfilling this mission, it is the IRC’s goal to provide a perspective that balances Reliability Standards with market practices so that each complements the other. The IRC is comprised of the Independent System Operator operating as the Alberta Electric System Operator (“AESO”); California Independent System Operator Corporation (“CAISO”); the Independent Electricity System Operator of Ontario (“IESO”); ISO New England Inc. (“ISO-NE”), Midwest Independent Transmission System Operator, Inc. (Midwest ISO”); New York Independent System Operator, Inc. (“NYISO”); PJM Interconnection, LLC (“PJM”); the Electric Reliability Council of Texas (“ERCOT”); and the Southwest Power Pool (“SPP”).

The AESO and IESO are not subject to this Commission’s jurisdiction. While the AESO and IESO concur with these joint comments of the ISO/RTO Council, this concurrence should not be construed as agreement or acknowledgement that their organizations are subject to this Commission’s jurisdiction. AESO and IESO also will submit separate comments to the related applications filed with the individual Canadian provinces based on the deadlines they will establish.

ERCOT has elected not to be a signatory to these joint comments of the ISO/RTO Council. Other ISOs or RTOs that join these comments may also submit separate, individual comments.

<sup>2</sup> The IRC moved to intervene on April 24, 2006 (with a corrected version submitted April 25, 2006).

<sup>3</sup> See Pub. L. No. 109-58, Title XII, Subtitle A, 119 Stat. 594, 941 to be codified at 16 U.S.C. § 824o (referred to as “FPA 215” or “Section 215 of the Federal Power Act”).

<sup>4</sup> Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards, Order No. 672, 71 FR 8662 (corrected at 71 FR 11505), FERC Stats. & Regs. ¶ 31,204, Order No. 672-A, 71 FR 19814 (2006), 114 FERC ¶ 61,328 (2006).

- The Application’s proposed voting structure for establishing Reliability Standards as applied to RTOs and ISOs is inconsistent with Congress’ mandates.
  - Changes are needed to the proposed penalty matrix and its implementation to address ISO/RTO status and to allow for a reasonable transition.
  - The Application is incomplete insofar as it fails to provide sufficient information, as required by Order No. 672, for the Commission to judge the appropriateness of the ERO carrying out non-statutory functions.
  - With regard to the performance of non-statutory functions, the Commission should send a clear signal to the industry that alternative models and institutions for carrying out such functions, similar to those utilized in the nuclear industry, should be developed.
- A. The IRC Supports the Commission Certifying NERC Corporation as the ERO.**

Subject to the conditions and caveats proposed herein, the IRC supports the North American Electric Reliability Council (“NERC Council”), on behalf of its affiliate, the North American Electric Reliability Corporation (“NERC” or “NERC Corporation”), seeking Commission certification of its Application to commence operations as the ERO. NERC is an international, independent organization and, at this juncture, is best positioned to serve as the entity certified to serve as the ERO. Representing a sector of the industry whose primary mission includes ensuring reliable operation of the North American Bulk-Power System, the IRC supports NERC commencing timely operations as the ERO. As several ISOs and RTOs testified before the United States Congress, the value of mandatory Reliability Standards is paramount and far-reaching.<sup>5</sup>

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<sup>5</sup> *Blackout 2003: How Did it Happen and Why?: Hearings Before the House Comm. on Energy and Commerce*, 108th Cong. 304 (2003) (statement of William J. Museler, President and CEO, NYISO) (“We believe that the reliability standards set by the NERC, which are now voluntary, should be made mandatory.”), available at <http://www.access.gpo.gov/congress/house>; *id.* at 314 (statement of David Goulding, CEO, The Independent Market Operator of Ontario) (“Mandatory enforceable reliability standards should be put in place where they do not exist.”); *id.* at 318 (statement of Gordon Van Welie, CEO, ISO-NE) (“Mandatory Reliability Standards Will Benefit Regulators by Depoliticizing Reliability”); *id.* at 325 (statement of Phillip G. Harris, President, PJM) (“Reliability standards should be made mandatory, with their development and enforcement overseen by a public body.”).

The Application's core provisions – *i.e.*, those relating to establishing and enforcing Reliability Standards and publishing periodic reliability reports – contain several principles that are critical to the IRC's support. Specifically, the Application proposes an American National Standards Institute (“ANSI”)-approved process for the development of Reliability Standards,<sup>6</sup> which importantly, includes *in principle* the continued coordination of its development of Reliability Standards with the North American Energy Standards Board (“NAESB”) and with the IRC.<sup>7</sup> (As discussed further below, however, the formal process proposed for developing Reliability Standards discriminates against ISOs/RTOs by limiting their effective input). Second, the Application provides rules for allocating equitably its costs among end users<sup>8</sup> through assessing its costs based on net energy for load. Third, the Application seeks to strive for fair and impartial procedures for enforcement of Reliability Standards.<sup>9</sup>

Notwithstanding the foregoing, the IRC believes that there are several areas of the Application that must be modified prior to NERC's certification in order to ensure the establishment of an effective, fair, and efficient ERO.

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<sup>6</sup> See 18 C.F.R. § 39.3(b)(2)(iv).

<sup>7</sup> See Application at Exhibit C, Appendix 1, p. 9 (acknowledging that the “Joint Interface Committee” (“JIC”), which is staffed by representatives of NERC, NAESB, and the ISO/RTO Council, will work to ensure that the development of wholesale electric business practices and reliability standards is harmonized and that every effort is made to minimize duplication of effort between NERC and the North American Energy Standards Board (NAESB).”) The JIC was established in a Memorandum of Understanding between North American Energy Standards Board and North American Electric Reliability Council, dated November 30, 2002 and filed in Docket No. RM01-12 on December 16, 2002, and later modified on May 15, 2003 to include the IRC. See Comments of the North American Energy Standards Board on the Second Technical Conference for docket No. RM05-30-000, Docket No. RM05-30-000 (filed Dec. 22, 2005).

<sup>8</sup> See 18 C.F.R. § 39.3(b)(2)(ii).

<sup>9</sup> See *id.* at § 39.3(b)(2)(iii).

**B. The Commission Must Condition its Approval of the Application.**

**1. The Proposed Rules of Procedure for Establishing and Enforcing Reliability Standards Are Flawed.**

Section 215 of the Federal Power Act makes clear the purposes of the ERO: to “establish and enforce reliability standards for the bulk-power system”<sup>10</sup> and to “conduct periodic assessments of the reliability and adequacy of the bulk-power system in North America.”<sup>11</sup> In its final rule for certifying the ERO, the Commission made clear that an Application must include, among other things: (1) balanced decision making for the ERO<sup>12</sup> and reasonable notice and opportunity for public comment, due process, openness, and balance of interests in developing Reliability Standards;<sup>13</sup> and (2) fair and impartial procedures for enforcement of Reliability Standards through the imposition of penalties in accordance with 18 C.F.R. § 39.7. While the Application generally achieves these goals, it falls short in two important ways.

First, and as discussed further in Section II.A, the Application fails to provide for balanced decision-making and due process in the establishment of Reliability Standards. Specifically, the application dilutes the role of ISOs/RTOs in reviewing standards as a result of its arbitrarily combining ISOs/RTOs with Regional Entities and Regional Reliability Organizations in a manner that creates a conflict of interest and dilutes the fair representation and balanced decision-making that Congress required. The proper organization of “stakeholder segments” is critical to ensuring a balanced process for review of proposed Reliability Standards.

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<sup>10</sup> See FPA § 215(a)(2).

<sup>11</sup> *Id.* at § 215(g).

<sup>12</sup> 18 C.F.R. § 39.3(b)(2)(i).

<sup>13</sup> *Id.* at § 39.3(b)(2)(iv).

Second, and as discussed further in Section II.B, the Application's procedures for enforcing Reliability Standards both: (1) ignore the Commission's directive in Order No. 672-A to take into account the status of the entity charged with violating the Reliability Standard – including the “unique characteristics of ISOs and RTOs,” such as their not-for-profit status<sup>14</sup> – in determining an appropriate penalty; and (2) fail to provide the requisite information to determine whether any penalty imposed for the violation of a Reliability Standard bears a “reasonable relation to the seriousness of the violation.”<sup>15</sup>

The IRC discusses in detail in Section II how the Commission can order straightforward solutions to these flaws.

## **2. The Application Fails to Address the Appropriateness of the ERO Performing Functions Not Specified by Congress.**

The Application proposes reliability-related functions for the ERO that either fall outside of its statutory scope or are described in such a manner as to suggest an unbounded scope.<sup>16</sup> While the IRC endorses the importance of such reliability-related functions as beneficial for reliable Bulk-Power System operations, as discussed in detail in Section II.C., the IRC agrees with the Commission that further examination is needed as to whether the applicant is the proper entity to perform such non-statutory functions.<sup>17</sup>

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<sup>14</sup> Order No. 672-A at P 56.

<sup>15</sup> 18 C.F.R. § 39.3(b)(2)(iii) (referring to 18 C.F.R. § 39.7(g)).

<sup>16</sup> For example, activities proposed in the Rules of Procedure (“ROP”) that, absent further explanation, might fall outside the statutory scope of Section 215 include: “Personnel Certification” (ROP § 600), “Readiness Audits” (ROP § 700), “Performance Analysis – ‘Analysis of Major Events’ ” (ROP § 807), “Training and Education” (ROP § 900), and “Situation Awareness and Infrastructure Security” (ROP § 1000).

<sup>17</sup> In Section 215 (a)(2), Congress made clear that “the purpose of [the ERO] is to establish and enforce reliability standards for the bulk-power system, subject to Commission review.” In Section 215(f), Congress required Commission approval of “any” proposed rule or proposed rule change accompanied by an explanation of its basis and purpose. Furthermore, the Commission’s regulations provide that the ERO “may not engage in any activity or receive revenues from any person that, in the judgment of the Commission represents a significant distraction from, or a conflict of interest with, its responsibilities under this part.” 18 C.F.R. § 39.4(g). To demonstrate that no such distractions or conflicts of interest exist, the ERO must first “file with the Commission its proposed entire annual budget for statutory and any non-

Unfortunately, and contrary to Order No. 672, the Application contains very little information concerning these functions and activities. As the Commission observed in Order No. 672, in order for the ERO to pursue functions not specified by Congress, the ERO must describe the function and supporting budget and business plan, explain why the function does not create a conflict of interest with the ERO's Congressionally-prescribed functions, and – because the Commission-approved funding mechanism may not be used to finance such activities – describe the separate funding mechanisms the ERO will use. This information is critical because, *inter alia*, it will help prevent the ERO from using the Commission-approved funding mechanism authorized by Section 215 to perform non-statutory activities. The applicant did not address this issue in any detail. As a result, the Application provides insufficient information for the Commission to reach its own conclusion, as opposed to accepting the applicant's "self-certification" that all of the activities would be appropriately performed by the ERO.

The IRC believes that, in order to effectively execute the findings of Order No. 672, the Commission should specifically endorse (or at least not rule out by simply accepting the applicant's word on the matter) the development of an industry model that avoids such conflicts. The Commission should strive to avoid problems associated with having the same entity setting and enforcing Reliability Standards and also providing the

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statutory activities ... with supporting materials, including the ERO's ... complete business plan and organization chart, explaining the proposed collection of all dues, fees and charges and the proposed expenditure of funds collected in sufficient detail to justify the requested funding collection and budget expenditures." *Id.* at § 39.4(b); *see also* Order No. 672 at P 198 (explaining how the ERO's completed business plan and entire budget "will provide the Commission with necessary information about any non-statutory activities, the course of their funding, and whether the pursuit of such activities presents a conflict of interest for the ERO").

tools, methods and/or training for ensuring compliance and promoting particular operational practices under the catch-all of identifying “operational excellence.”<sup>18</sup>

The industry is at a critical crossroads in developing new reliability organizations and structures. The IRC, therefore, urges the Commission to signal to the industry the need to develop a separation between the standard and enforcement functions of the ERO from the provision of products and services designed to meet compliance with Reliability Standards.<sup>19</sup> The IRC supports the development of a model, similar to that utilized in the nuclear industry, and requests that the Commission make clear in its Order that it would like to see further development of this type of model rather than merely freezing the status quo, as would be the case if the Commission implicitly accepts the existing model exemplified by the NERC organization today.

In this regard, the Commission should look at other organizational models for promoting reliable operations, such as, for example, the compliance model developed by the nuclear power industry. The Nuclear Regulatory Commission (“NRC”), like the ERO, is the entity that establishes standards and enforces them. Separate from the NRC, the nuclear industry, on its own, created the Institute of Nuclear Power Operations (“INPO”)<sup>20</sup> to promote excellence in safety and operation of nuclear electric generating plants through its cornerstone programs. These programs are:

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<sup>18</sup> NERC currently promotes software tools for compliance with its current reliability standards. Examples include the NERC “tagging” system and the Interchange Distribution Calculator. Although useful, such products should be subject to competitive development and not the anointed means of compliance.

<sup>19</sup> The IRC does not discuss here the issues identified in PP 699 and 700 of Order No. 672, wherein the Commission focuses on the need to identify separation plans that show “full independence between the enforcement/Reliability Standard development and the transmission operations” of a combined system operator/regional reliability council that is currently in operation that may seek Regional Entity status.

<sup>20</sup> INPO was formed in 1979 as a non-profit, member-supported organization based in Atlanta, Georgia. The organizational structure is similar in many ways to a typical U.S. corporation, with a Board of Directors, elected by INPO’s members. Although it has its own employees, INPO augments its activities by utilizing the expertise of loaned employees from its members and participants.

- **Evaluations:** periodic evaluations conducted at each operating nuclear plant in the country (typically on an 18 to 24 month basis);
- **Training and Accreditation:** various accredited training programs for key personnel, such as plant operators;
- **Events Analysis and Information Exchange:** systematic gathering, review and evaluation of operating experience and exchange of such information with nuclear plant licensees; and
- **Assistance:** visits in response to member requests to evaluate plant performance against best industry practices in specific areas, such as operations, maintenance, and training.

These functions are very similar – if not identical – to the non-statutory functions proposed in the Application.

Having two entirely distinct organizations appropriately separates Reliability Standard establishment and enforcement from the tasks of assisting the industry in providing tools and services for complying with Reliability Standards, and in otherwise achieving standards of excellence. Under this bifurcated model, other tasks necessary for achieving and promoting reliable Bulk-Power System operations would be the sole mission of an independent technical organization.<sup>21</sup> This model would reduce any conflicts of interest that might arise if a single organization was tasked with the responsibility for enforcing compliance and providing services to aid compliance. Moreover, such a structure would introduce competition and innovation in the provision of compliance products and services rather than risk creating a monopoly if such tools were provided by the standard setting and enforcement body itself. Furthermore, the nuclear industry's experience has clearly shown that utilities are more willing to set challenging goals and to diligently strive for excellence if they know their efforts will not

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<sup>21</sup> Such an organization should function on an international basis, in keeping with the international nature of NERC and the bulk power system.

be subject to regulatory sanction or criticism, something that likely could not be avoided if a regulatory entity were responsible for promoting operational excellence as well as regulatory compliance.

The IRC seeks additional information from the applicant as to the scope of the non-statutory functions that it intends to conduct as well as a clear signal from the Commission driving the industry towards the development of an alternative competitive structure. Were the Commission to merely accept the status quo, it would be implicitly endorsing the present model and creating a significant barrier to the development of such an alternative.

## II. COMMENTS

### A. **Comments on the Flaws in the Proposed Rules for Establishing Reliability Standards (Rules Of Procedure Section 300 – Reliability Standards Development).**

Under Section 215 of the Federal Power Act, one of the core purposes of an ERO is to establish Reliability Standards. The Federal Power Act requires that the ERO have rules that “assur[e]. . . balanced decision-making in any committee or subordinate organizational structure” and “provide for . . . balanced of interests in developing reliability standards.”<sup>22</sup> Likewise, under the Commission’s regulations, an ERO Application must propose rules that ensure “balanced decisionmaking in any [ERO] committee or subordinate organizational structure”<sup>23</sup> and “[p]rovide . . . due process, openness, and balance of interests in developing Reliability Standards.”<sup>24</sup>

In Section 305 of the “Rules of Procedure,” the Application provides for a “Registered Ballot Body” to approve proposed Reliability Standards before those

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<sup>22</sup> FPA § 215 (c)(2)(A) and (D).

<sup>23</sup> 18 C.F.R. § 39.3(b)(2)(i).

<sup>24</sup> *Id.* at § 39.3(b)(2)(iv).

Standards are submitted to the ERO Board for transmittal to the ERO's Regulatory Authorities. Because this part of the Application forms the foundation for the establishment of mandatory Reliability Standards and is directly tied to a statutory requirement, it is a key element for NERC to obtain certification as the ERO and to promote reliable Bulk-Power System operations. This Proposed "Rule of Procedure" fails to meet the Commission's requirements, because it does not provide for balanced decisionmaking, a balance of interests and due process. This proposed process would unduly discriminate against ISOs/RTOs and arbitrarily limit the review and approval process associated with the development of Reliability Standards.

**1. The Proposed Balloting Body Segments Must Be Modified to Create a Separate Segment for ISOs/RTOs In Order to Meet the Statute's Requirements.**

The Application appropriately proposes to create a truly separate ISO/RTO industry segment on the ERO's Member Representatives Committee.<sup>25</sup> Moreover, the Application appropriately proposes to continue to rely on the Joint Interface Committee (consisting of NERC, NAESB and IRC representatives)<sup>26</sup> for coordinating work on Reliability Standards and wholesale electric business practices. The proposal for the Registered Ballot Body and Standards Committee, however, arbitrarily and capriciously dilutes the ISO/RTO vote on proposed Reliability Standards by grouping ISOs/RTOs with "Regional Entities" and "Regional Reliability Organizations" for purposes of voting. There is no basis for treating ISOs/RTOs differently in these two voting bodies. The Registered Ballot Body voting structure establishes the very potential conflict of interest

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<sup>25</sup> Application at Exhibit B ("Bylaws") at Art. II, Section 4. The Members Representatives Committee is responsible for: (a) electing the independent trustees; (b) voting on amendments to the Bylaws; and (c) providing advice and recommendations to the ERO Board with respect to the development of annual budgets, business plans and funding mechanisms, and other matters pertinent to the purpose and operations of the Corporation. *See id.* at Art. VIII, Section 1.

<sup>26</sup> *See supra* n.7.

the Commission raised in a different context in Order No. 672 as to the relationship of ISOs/RTOs to Regional Entities. Moreover, it ignores Commission precedent concerning the unique functions performed by ISOs/RTOs.<sup>27</sup> As detailed below, there are multiple reasons why their voice should not be diluted in the Reliability Standards development process.

First, ISOs/RTOs perform completely different functions than Regional Entities and Regional Reliability Organizations. Regional Entities will propose and enforce Reliability Standards, and Regional Reliability Organizations will most likely become the Regional Entities.<sup>28</sup> Regional Entities will constitute the primary enforcers of Reliability Standards, performing functions similar to those of the ERO, only on a regional basis. In contrast, ISOs/RTOs operate transmission systems and wholesale markets. The Commission acknowledged these important differences in Order No. 672 when it established rigorous criteria, including separation of functions requirements, that ISOs/RTOs would have to meet if they intended to perform Regional Entity functions.<sup>29</sup> It would be arbitrary and capricious to erect these barriers to combining ISOs/RTOs with Regional Entities and Regional Reliability Organizations by noting potential conflicts if

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<sup>27</sup> See, e.g., Order No. 672-A at P 56 (recognizing that ISOs/RTOs have unique characteristics); Order No. 672 at P 634 (same); Accounting and Financial Reporting for Public Utilities Including RTOs, Order No. 668, 113 FERC ¶ 61,276 at P 3 (2005) (“RTOs perform some unique functions, not traditionally performed by other public utilities [because] they oversee markets and they conduct long-term system planning on a regional basis.”); *Midwest Independent System Transmission Operator, Inc.*, 108 FERC ¶ 61,143 at P 27 (2004) (“The RTOs have the unique responsibility for looking at and planning for the entire region.”); Quarterly Financial Reporting and Revisions to the Annual Reports, 106 FERC ¶ 61,113 at P 59 (2004) (acknowledging the “unique utility business model” of ISOs/RTOs).

<sup>28</sup> The IRC respectfully submits that if the Application intends to refer to different classes of entities through its definitions of “Regional Entities” and “Regional Reliability Organizations”, then the Application must be modified to provide a *functional definition* of “Regional Reliability Organization.” Currently, the Application defines “Regional Reliability Organizations” by *reference to the names of the current Regional Reliability Councils*. If these entities’ mission or scope of responsibilities change, and include functions not incorporated into their Regional Entity function, then it will be unclear whether reference to such entities as “Regional Reliability Organizations” makes sense.

<sup>29</sup> See, e.g., Order No. 672 at P 698 (“The Commission is concerned, however, that an RTO or ISO may have an inherent conflict of interest if it is also a Regional Entity itself. The same institution would operate the Bulk-Power System and be responsible for overseeing its own compliance with Reliability Standards.”).

they were combined, and then turning around and allowing these two entities to be treated as the same for purposes of voting in the Registered Ballot Body.<sup>30</sup>

In addition, because Regional Entities will act on the ERO's delegated authority, and will therefore be dependent on the ERO for their budgets,<sup>31</sup> they will effectively act as the ERO's agents. Including Regional Entities in the ISO/RTO stakeholder segment therefore results in the ERO and its agents diluting the ISO/RTO balloting body vote. The ERO and its agents do not have the same authority with regard to any other stakeholder segment, and therefore the ISO/RTO vote is diminished relative to other industry segments. Moreover, because Regional Entities may have "hybrid" or "stakeholder" Boards, including such entities in the ISO/RTO segment would dilute the voice of independent ISOs/RTOs with regard to concerns about reliability.

Furthermore, no other industry segment in the Registered Ballot Body and the Standards Committee includes two different types of entities that perform completely different functions. It is arbitrary and capricious to dilute the ISO/RTO vote in this manner, and not do the same for any other industry segment.

Finally, as independent market operators, ISOs/RTOs provide an informed, expert, and independent opinion on the effect a proposed standard might have on competition. Because the "Commission will not defer to the Electric Reliability Organization or a Regional Entity with respect to the effect of a proposed Reliability

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<sup>30</sup> Although it is true that these entities have been combined in the present NERC voting structure, there was no Congressional directive nor Commission jurisdiction over the decision-making process as now exists with the ERO. Moreover, the Regional Entities will serve as agents for the ERO under delegated authority, unlike extant structure in which they constitute separate entities—each with separate arrangements and authority over users of the bulk power grid.

<sup>31</sup> See ROP § 1104.2 ("NERC shall review and approve each regional entity's budget for adequacy in meeting requirements of its delegated authority.").

Standard or a proposed modification to a Reliability Standard on competition,”<sup>32</sup> the ISO/RTO voice adds unique value on evaluating such questions during the Reliability Standard development process. All of this perspective will be unreasonably diluted in contravention of Congress’s admonition for fair and balanced decision-making.

**2. The Requirement for a Sector to Cast Ten Votes to Obtain Full Valuation Discriminates Against ISOs/RTOs and Was Not Vetted by NERC.**

In addition to requiring the Application to create an ISO/RTO-only segment for purposes of representation on the Standards Committee and in the Registered Ballot Body, the Commission should require NERC to waive the ten-vote minimum requirement for full valuation for an ISO/RTO-only segment.<sup>33</sup> Currently, a truly-independent ISO/RTO sector would consist at most of only nine members. Under the proposed Step 9 of the Standards Development Process, the weight of the ISO/RTO sector vote would be reduced, because it requires at least ten entities to vote in a segment for it to receive its full weight.<sup>34</sup> This result would be unduly discriminatory and make poor public policy. No such minimum requirement exists with respect to ISO/RTO representation on the Member Representative Committee as a separate industry segment; it is arbitrary and unreasonable to include such a minimum requirement for an ISO/RTO industry segment in the standard development process. As independent system operators with no economic stake in particular market outcomes, ISOs/RTOs have a unique interest and perspective that cannot be adequately represented in the standards development process by other electricity sector players. The Reliability Standards arguably will play a greater role in

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<sup>32</sup> 18 C.F.R. § 39.5(c)(3).

<sup>33</sup> Application at Exhibit C, Appendix 1 at page 19.

<sup>34</sup> *Id.* Specifically, Step 9 includes the requirement that “[i]f there are less than ten entities that vote in a segment, the vote weight of that segment shall be proportionally reduced.”

the daily operations of ISOs/RTOs than any other sector. Although additional ISOs/RTOs might develop in the future, there is no guarantee if or when there will be at least ten. In short, the realities of ISO/RTO development compel a waiver of this rule for this segment.

**B. Comments on the Flaws in the Proposed Rules for Enforcing Reliability Standards (Rules Of Procedure Section 400 – Compliance Enforcement).**

Section 407.2 of the Rules of Procedure provide that the “*ERO Sanction Guidelines*, which are incorporated into these rules as Appendix 4, [are to be used] to develop an appropriate penalty, sanction, or remedial action for a violation...” By acknowledging that NERC is field-testing the penalties and may file revisions in October 2006,<sup>35</sup> the Application appears to recognize that the Commission need not give final approval to a penalty matrix at this time. Because the Application includes the matrix, however, the IRC provides the following two comments.<sup>36</sup>

First, it is premature for the Commission to accept the penalty matrix as proposed, because its full import cannot be evaluated until the Commission has fully reviewed the proposed Reliability Standards that the penalty matrix will be used to enforce.<sup>37</sup> It is impossible to judge whether the penalty matrix assigns penalties in “reasonable relation to the seriousness of the violation”<sup>38</sup> without first evaluating the relevant Reliability

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<sup>35</sup> See Application at Exhibit F (“Electric Reliability Organization Transition Plan From Application to Operation”), at p. 14-15.

<sup>36</sup> The NYISO fully supports these comments but, at the same time, expressly does not waive and is reserving all of its appellate rights, including with respect to Order Nos. 672 and 672-A, concerning the possible imposition of financial sanctions against ISOs/RTOs.

<sup>37</sup> The Commission has indicated that it will take a steady and careful approach before accepting any Reliability Standards. The Commission recently announced that its staff would release its preliminary assessment of NERC’s proposed Reliability Standards, then hold a technical conference and allow for comments. The Commission anticipates that, after this process, it will issue a Notice of Proposed Rulemaking on the Reliability Standards in July 2006. See Notice Announcing Rulemaking Process, Mandatory Reliability Standards for the Bulk-Power System, Docket No. RM06-16-000 (Apr. 18, 2006).

<sup>38</sup> 18 C.F.R. § 39.7(g).

Standards. Without knowing the Reliability Standards themselves, it is difficult to evaluate whether the penalty matrix properly accounts for the severity of each type of violation.

Second, the Application fails to consider the guidance offered by the Commission in Order No. 672-A, where the Commission “acknowledge[d]... the unique characteristics of ISOs and RTOs and agree[d] that, in determining a penalty, circumstances such as organizational structure or not-for-profit status *will be* considered.”<sup>39</sup> The proposed penalty matrix that is included in the *ERO Sanctions Guidelines* makes no attempt to explain how such factors as organizational structure or not-for-profit status will be recognized. Notably, while the *ERO Sanctions Guidelines* contain a number of penalty adjustment factors (*e.g.*, the entity’s size), there are no adjustment factors that recognize the considerations ordered by the Commission. The Commission should direct NERC to modify the *ERO Sanctions Guidelines* to expressly incorporate Order No. 672-A’s directive with respect to ISOs/RTOs.

**C. Comments on Issues Raised by the ERO Performing Non-Statutory Functions.**

As explained above, the IRC strongly supports the value of the non-statutory reliability-related functions described in this Application. At the same time, the IRC believes that there would be a number of critical problems if the ERO were to take on such functions. As such, the IRC encourages the Commission to allow the formation of a separate INPO-type entity to perform reliability-related non-statutory functions. The following discussion identifies some of the issues that may arise if, as proposed in the Application, the ERO performs these non-statutory activities.

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<sup>39</sup> Order No. 672-A at P 56 (emphasis added).

**1. Situation Awareness and Infrastructure Security (Rules Of Procedure Section 1000).**

For Situation Awareness and Infrastructure Security (“ROP” Section 1000), the Application proposes to have the ERO “monitor present conditions on the bulk power system and provide leadership coordination, technical expertise, and assistance to the industry in responding to events as necessary.”<sup>40</sup> This proposal includes the ERO developing the ability to “[m]aintain real-time situation awareness of conditions on the bulk power system” and “[n]otify the industry of significant bulk power system events that have occurred in one area, and which have the potential to impact reliability in other areas.”<sup>41</sup> The IRC believes strongly in the value of improving situational awareness as concerns the bulk power system in North America.

However, as discussed below, the Application both: (a) appears to propose functions for the ERO that deal with matters other than situational awareness, and otherwise (b) provides insufficient detail to properly evaluate whether the ERO’s proposed activities are appropriate.

a. Potential Conflicts of Interest.

Certain aspects of this part of the Application clearly highlight a potential conflict of interest for the entity responsible for establishing and enforcing Reliability Standards. For example, NERC proposes that, as ERO, it will develop specific software tools to implement NERC tagging requirements, as well as an Interchange Distribution Calculator (“IDC”) tool.<sup>42</sup> However, the provision of these types of products could create the very

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<sup>40</sup> ROP § 1001.

<sup>41</sup> *Id.*

<sup>42</sup> For example, ROP § 1002 explains: “NERC will provide tools and other support services for the benefit of reliability coordinators and other system operators, including the Area Control Error (ACE) and Frequency Monitoring System, NERC Hotline, Real-time Flows, System Data Exchange (SDX), Reliability Coordinator Information System (RCIS), Transmission Services Information Network (TSIN), Interchange

conflicts of interest and mission confusion that the Commission was concerned about in its ERO Certification Rulemaking.<sup>43</sup> For one, if the ERO provides these tools and services, that function could, as a practical matter, have a chilling effect both on the development of competitive offerings and innovation that can come from multiple suppliers of such products.<sup>44</sup> As such, the entity setting and enforcing reliability standards could very well become the *sole provider* of unregulated tools and products to comply with those standards. In short, the ERO should be the standard setting and enforcement entity, not an entity charged with implementing its own standards. Under an INPO-type model, vendors and/or industry organizations separate from the ERO would provide such tools.

b. Concerns Regarding Undefined, and Potentially Unlimited, Scope of Activities.

The Application also fails to provide sufficient detail explaining how NERC proposes to perform “situational awareness” functions. Absent this explanation and clarification, the Application could be read to provide the ERO with an unlimited scope of authority that could include the exercise of real-time operating authority. While this may not be NERC’s intent, the Commission must make clear that its certification of NERC as the ERO does not include granting NERC operational authority or the authority to direct system operators how to respond to real-time events. Failure to provide this clarification can undermine reliability by creating confusion about operational hierarchy during real-time system conditions. Ensuring that there is only “one set of hands on the

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Distribution Calculator (IDC), Interregional Security Network (ISN), and Central Repository for Security Events (CRC).”

<sup>43</sup> See Order No. 672 at P 198.

<sup>44</sup> The situation is analogous to the Board of Bar Examiners in a given jurisdiction also offering bar review programs as a separate offering. Although competitors could theoretically enter the market, the consumer will inevitably move toward the program offered by the entity developing and grading the examination itself, thus stifling competitive alternatives.

wheel” during real-time system operations is critical to promoting a reliable Bulk-Power System.

The IRC recognizes that during the ERO Application Stakeholder Process, NERC deleted language from the draft Application that had explicitly provided NERC with operational authority, as it directed that NERC would “coordinate *emergency* response as necessary.”<sup>45</sup> Although the IRC supports NERC’s decision to delete this phrase, the remaining language may still lend itself to similar interpretation. Without further explanation, retaining the language allowing NERC to “provide leadership coordination”<sup>46</sup> raises the possibility that NERC would interpret its Rules of Procedure to direct real-time actions. In fact, the ability to make such real-time decisions would turn NERC into a public utility under the Federal Power Act<sup>47</sup> – a result clearly not contemplated by Congress.

If NERC intends to engage in real-time system operations, this Application does not address the potential conflicts of interest or cost impacts inherent in such a proposal. Given the ERO’s position as enforcer of Reliability Standards, system operators could be pressured to abandon their expert real-time judgment about safe system operations for fear of repercussions stemming from an ERO sanction by virtue of the system operator disagreeing with the “ERO Operator.” In addition, system operators might feel

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<sup>45</sup> Compare North American Electric Reliability Council, Draft II ERO Application (dated Jan. 26, 2006) at Exhibit C, Section 1001 (“NERC shall through the use of reliability coordinators and available tools, monitor present conditions on the bulk power system and *coordinate emergency response as necessary.*”) (emphasis added) with Application at Exhibit C, Section 1001 (“NERC shall through the use of reliability coordinators and available tools, monitor present conditions on the bulk power system and provide leadership coordination, technical expertise, and assistance to the industry in responding to events as necessary.”).

<sup>46</sup> ROP § 807.

<sup>47</sup> See, e.g., *Bechtel Power Corp.*, 60 FERC ¶ 61,156 at 61,573 (1992) (explaining that one entity “operates” another, and therefore constitutes a public utility, if it obtains control and decision-making authority concerning the sale or transmission of electric energy); see also *D.E. Shaw Plasma Power, LLC*, 102 FERC ¶ 61,265 at 61,285 (2003) (finding an entity to be a public utility in part because it proposed to have the authority to recommend to another public utility what jurisdictional energy sales it should make).

compelled to always seek *a priori* approval from the “ERO operators” to avoid penalty from the ERO in the ERO’s Reliability Standard enforcer function. These added communications could make reliable real-time system operations difficult or impossible, or otherwise add significant costs to how the system is operated. The ERO cannot effectively execute its statutory responsibility to enforce reliability standards if it becomes an active participant in the operational process.

**2. Reliability Readiness Audit and Improvement (Rules Of Procedure Section 700).**

The IRC firmly believes that readiness audits play an important role in helping Bulk-Power System operators prepare for emergencies. In the nuclear power industry, such audits help achieve reliability excellence but are performed not by the regulator (NRC), but by separate industry groups, such as INPO. While NRC enforces reliability compliance, INPO promotes operational excellence. The IRC believes the Commission should signal the need for development of a structure that imposes a similar distinction between the ERO’s statutory duties and other reliability-related functions as detailed above.

Clearly, the ERO has the authority and should perform compliance audits to enforce reliability standards, and NERC has proposed performing such audits in Section 400 of the Rules of Procedure. Readiness audits as described in Section 700 of the Rules of Procedure, however, are unrelated to assessing compliance with Reliability Standards. The Application acknowledges that the proposed Reliability Readiness Audit program “*is not a part of the compliance enforcement program.*”<sup>48</sup> Instead, it is designed to ensure “*the ability to perform and achieve excellence during a system emergency or*

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<sup>48</sup> Application at Exhibit C, Appendix 7 (Reliability Readiness Audit and Improvement Program Procedure & Appeals Process) at p. 1 (emphasis added).

*disturbance*”<sup>49</sup> and “that operators of the bulk electric system have the facilities, tools, processes, and procedures in place to operate reliably under future conditions.”<sup>50</sup> The audit procedure will use the Reliability Standards only as a “foundation[] supplemented by other reference documents and audit criteria.”<sup>51</sup> Although Order No. 672 acknowledges that an ERO could conduct “readiness audits” to help prepare its periodic reliability reports,<sup>52</sup> NERC has designed the proposed Reliability Readiness Audit program to achieve purposes beyond its statutory authority.

It is difficult to judge the appropriateness of the ERO performing this non-statutory duty (or, put differently, performing this duty for non-statutory purposes) without the ERO providing more information to assure that conflicts of interest can be avoided. The Commission should defer judgment until NERC submits a complete business plan, budget and explanation.<sup>53</sup> While there may be benefits to having the ERO perform readiness audits, there may be downsides, such as causing confusion between Reliability Standard compliance requirements and industry “best practices.” The nuclear industry provides an appropriate model of having entities separate from the regulator determine, evaluate, and provide guidance on how to achieve such excellence.

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<sup>49</sup> ROP § 701 (emphasis added).

<sup>50</sup> *Id.*

<sup>51</sup> Application at Exhibit C, Appendix 7 at p. 1.

<sup>52</sup> Order No. 672 at P 805 (“With respect to the concerns about the scope and content of the reliability and adequacy assessments prepared by the ERO, the Commission expects each assessment to be comprehensive in order for the Commission, the ERO, and the Regional Entities to fulfill their respective oversight responsibilities. As will be established in later proceedings, we would expect that such assessments could include, for example, operating and planning reports, reports of ongoing activities such as readiness audits, seasonal reliability assessments, as well as relevant recommendations. In addition, the Commission may determine that reliability and adequacy assessments should include appropriate metrics, if applicable, to assist the Commission in monitoring actual reliability performance and plans.”).

<sup>53</sup> See Order No. 672 at P 198.

Finally, the IRC believes that if the ERO conducts readiness audits, the audit team's report should not be publicly disclosed until the appeals process is complete.<sup>54</sup> The disclosure of the audit results should mirror the procedure for public posting of sanctions that occurs only after due process has been completed.

**D. Specific Comments on Exhibit F of the Application (The ERO Transition Plan)**

The IRC generally supports the Application's proposed transition plan to allow for testing the application of the penalty matrix to actual situations before assessing actual penalties. The IRC recommends, however, that this phase-in period last an entire year (*e.g.*, calendar year 2007), instead of ending July 1, 2007 as proposed in the Application. The IRC respectfully submits that the full value of phasing-in penalties cannot be realized unless a full twelve-month period is employed. Because the likelihood of reliability problems may be related to different seasons and because there are numerous Reliability Standards proposed, it makes sense to allow a full year to see to see how the updated penalties work and how the ERO will interpret Reliability Standards after NERC expects to commence such operations on January 1, 2007.

A phased-in approach to enforcing Reliability Standards is also appropriate, because the currently-proposed Reliability Standards generally allow for *multiple*, reasonable interpretations in defining "who" is responsible for performing "what" in assuring reliability. In an enforceable context and with the threat of financial sanction, there are three reasons why these Reliability Standards are more vague than they ultimately should be. First, the NERC Functional Model definitions, which would identify which entities are considered "users, owners and operators" of the Bulk-Power

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<sup>54</sup> ROP § 711(4) ("The final report shall be posted by NERC for public viewing according to the *ERO Guidelines for Reporting and Disclosure*, which are incorporated into these rules in Section 408.").

System responsible for adhering to any given Reliability Standard, remain subject to ongoing review to fix ambiguities.<sup>55</sup> Second, NERC is still undertaking its certification and registration process to identify entities under its Functional Model. Third, NERC itself has recognized that certain of its Reliability Standards contain missing elements that would be required for compliance assessment and enforcement.

Therefore, the Commission should require the proposed ERO phase-in period – in which violations will be identified but penalties will not be assessed – to last an entire year.

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<sup>55</sup> By way of example, the IRC would note that NERC has received specific recommendations from the Functional Model-Reliability Standards Coordination Task Force to modify certain of its definitions.

### III. CONCLUSION

WHEREFORE, in view of the foregoing, the IRC respectfully requests that: (1) it be permitted to intervene with all the rights that attend to such status; and (2) the Commission take action consistent with the comments set forth herein.

Respectfully submitted,

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Dated: May 4, 2006

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 4<sup>th</sup> day of May, 2006.

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