

DOE's NOTICE OF INQUIRY ON MANDATORY ELECTRIC RELIABILITY STANDARDS

COMMENTS OF THE ELECTRIC POWER SUPPLY ASSOCIATION

January 4, 2001

On November 20, 2000, the Department of Energy (DOE) issued a Notice of Inquiry (NOI) concerning a possible rulemaking under which the Federal Energy Regulatory Commission (FERC or Commission) would exercise the full extent of its authority to impose mandatory reliability standards. Expressing concern about Congressional inaction and the limitations of traditional approaches to reliability in the new age of competitive markets, DOE is considering exercising its authority under section 403 of the DOE Organization Act to initiate an electric reliability rulemaking at FERC.

In its NOI, the DOE requested comments on specific questions, including the efficacy of voluntary compliance with industry reliability rules, actions FERC could take to promote reliability and how to establish effective relationships between Regional Transmission Organizations (RTO) and a mandatory reliability organization. The Electric Power Supply Association (EPSA) commends the DOE for this initiative and is pleased to submit comments on several of the questions raised in the NOI.

EPSA is the national trade association representing competitive power suppliers, including independent power producers, merchant generators and

power marketers. EPSA members provide reliable, competitively priced electricity from environmentally-responsible facilities in the U.S. and global power markets. EPSA seeks to bring the benefits of competition to all power customers.¹ As both power marketers and generators, EPSA members are vitally interested in, and actively support, the effort to harmonize reliability measures with the continued development of robust and workable competitive markets.

I. INTRODUCTION—THE INSEPARABILITY OF MARKETS AND RELIABILITY

As we face the challenges of the unprecedented effort to restructure our electric power industry, it is imperative to recognize the inextricable link between system reliability and the successful development of robust, competitive wholesale markets. The recommendations of both the Secretary of Energy Advisory Board's Task Force (Task Force) and the Department of Energy's Power Outage Study Team (POST) mentioned in the NOI are largely based upon this fundamental reality. EPSA shares the concern the DOE expressed in its NOI that "voluntary self-regulation of reliability issues may not be sufficient." Indeed, the discretion afforded utilities under the existing voluntary reliability scheme perpetuates barriers to fully competitive markets. The continuation of this status quo prolongs the transition to competitive commercial markets and, therefore, itself poses a serious threat to reliability.

¹ The comments contained in this document represent the position of EPSA as an organization, but not necessarily the view of any particular member with respect to any specific issue.

To ensure reliability by continuing the development of robust competitive electric power markets requires significant changes in the ownership, control and operation of the bulk power transmission system. The elimination of the remaining barriers to fully competitive markets is one of the primary objectives of Order No. 2000.² The Commission's discussion of the basis for RTOs confirms the vital interplay of efficient, non-discriminatory grid management and market performance. In this regard, theoretical distinctions between "reliability" and market development are difficult, if not meaningless. In fact, standards, rules and procedures under one of these rubrics inevitably impacts the other. Any new, mandatory reliability institution must embrace this reality.³

In Order No. 2000, the Commission noted that "there remain important transmission-related impediments to a competitive wholesale electric market".⁴ The Commission placed these impediments into two broad categories: "(1) engineering and economic inefficiencies inherent in the current operation and expansion of the transmission grid" and "(2) continuing opportunities for

² Regional Transmission Organizations, III FERC Stat. & Regs. ¶31,089 (Dec. 20, 1999) (Order No. 2000).

³ On February 8, 2000 the NERC Board of Trustees launched a "Market-Reliability Interface Collaborative Planning Initiative" to develop market-based solutions to congestion management and related market-reliability interface issues. Over 200 individuals helped prepare a report containing an Industry Vision, Guiding Principles, Industry Goals and an Action Plan. While the Board will consider further actions to follow-up on the report, it rejected three of the five recommendations of the Collaborative's Executive Team "because it believed that industry-wide promulgation of the full set of principles and goals of the report would require actions that exceed NERC's mission as a reliability organization." (NERC Board Minutes Oct. 12-13,2000). The Board's view may accurately reflect NERC's historical role; however, it betrays serious limitations in its ability to make the institutional adjustments necessary to respond to the challenge of making system reliability compatible with effective competitive markets.

⁴ Order No. 2000 at 31,003.

transmission owners to unduly discriminate in the operation of their transmission systems so as to favor their own or their affiliate's power marketer activities.”⁵

In the introduction to Order No. 2000, the Commission explained the basis for the next steps necessary to realize the policy goals underlying open access to transmission. The Commission emphasized that it “reviewed evidence that traditional management of the transmission grid by vertically integrated electric utilities was inadequate to support the efficient and **reliable** operation that is needed for the continued development of competitive electricity markets, and that continued discrimination in the provision of transmission services by vertically integrated utilities may also be impeding fully competitive electricity markets.”⁶ The Commission further stated that “these problems may be depriving the Nation of the benefits of lower prices and **enhanced reliability**.”⁷

In its report, the POST submitted 12 recommendations to the Secretary of Energy based upon the team's review of electric reliability events in the summer of 1999. The POST stressed the importance of promoting market-based approaches to reliability in emphasizing that its recommendations took into consideration a new factor--“an industry that is undergoing extensive restructuring...based upon the fundamental principle that competition and markets, not regulators and utilities, result in better investment and operating decisions with respect to generation and consumption of electricity. Mechanisms

⁵ Id.

⁶ Id. at 30,992-993 (emphasis added).

⁷ Id. at 30,993 (emphasis added).

that will ensure adequate supplies of electricity—and reliable operations—should be designed with this principle in mind.”⁸

The best guarantor of reliability is a robust competitive market.⁹ The ability of suppliers to meet the demands of customers in a robust, liquid competitive market protects against price volatility as it enhances reliability. For the safeguards to work, however, market participants must have confidence that they are being treated fairly and comparably and that transactions can be completed in a predictable, stable manner. In addition, market participants must see the proper price signals and incentives to make longer-term infrastructure investments. The actions of any new mandatory reliability organization must improve transmission operations without undermining competitive wholesale markets. EPSA members are committed to improving and maintaining the reliability of today’s electricity system—indeed, their business success depends upon it.

⁸ POST Report at S-1.

⁹ Reliability encompasses both system security (often considered short-term or real-time considerations) and adequacy (which encompasses a longer-term planning horizon). Well functioning markets require, and can produce, a high degree of both security and adequacy. However, in a competitive market, the “cost” of reliability is not infinite. Transmission customers must be able to know and price the actual level of service supplied and energy suppliers and customers must be able to see and respond to price signals.

II. EPSA's RESPONSES TO SPECIFIC QUESTIONS IN THE NOI

1. Is the existing arrangement of voluntary compliance with industry reliability rules sufficient to ensure reliability of the bulk power transmission system? If not, why not, and has reliability been jeopardized by violations of the existing bulk power reliability standards?

When explaining its recommendation that government and industry support mandatory reliability standards for the bulk power system, the POST stated that the interconnected electric power system is being “transformed” from one dominated by vertically-integrated utilities to “one that will support a vibrant, competitive market. This change makes the current system of voluntary compliance with reliability standards inadequate for ensuring reliability. Mandatory standards for bulk power systems are needed to ensure that the ‘rules of the road’ are implemented in a straightforward and balanced manner.”¹⁰ EPSA agrees.

Simply put, the traditional voluntary approach to developing and implementing reliability standards is obsolete and ineffective. In addition to adequacy and the need to promote the construction of generating facilities, any meaningful discussion of “reliability” must focus on the access to, and operation of, the wholesale transmission system. The Commission itself has characterized open access transmission as “the foundation necessary for competitive wholesale power markets”, and endorsed the fundamental policy determination that enhanced reliability depends upon more efficient grid management and

¹⁰ POST Report at S-5.

removing the incentive and opportunity for discriminatory transmission practices.¹¹

The simple fact is that current NERC reliability standards and policies are unduly vague and allow an unacceptable amount of discretion by transmission providers and system operators. Accordingly, reliability is jeopardized not only by outright “violations” of existing standards, but by the plethora of procedures from which transmission owners can select the one best suited for their own individual competitive advantage. This problem is particularly acute with respect to those utilities that have unregulated affiliates engaged in wholesale marketing activity while continuing to serve “native load.” By placing native load (which comprises nearly 80 percent of all transmission service) outside of pro forma tariff requirements, the Commission’s open access requirements—and their reliability -related objectives—are immeasurably weakened. Similarly, markets are jeopardized where discretionary system operation implements overly conservative reliability standards.

Existing reliability standards have been developed, and are interpreted and applied, by vertically-integrated utilities and those associated with them whose interests are often adverse to competitive markets. This is partly due to improper or non-existent incentives, which Order No. 2000 is intended to address.¹² The inherent danger of this problem was apparent to FERC when it issued Order No.888:

¹¹ Order No. 2000 at 30,992-993.

¹² “In the NOPR, the Commission noted that functional unbundling does not change the incentives of vertically integrated utilities to use their transmission assets to favor their own

It is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is inferior to that which they provide themselves. The inherent characteristics of monopolists make it inevitable that they will act in their own self-interest to the detriment of others by refusing transmission and/or providing inferior transmission to competitors in the bulk power markets to favor their own generation, and it is our duty to eradicate unduly discriminatory practices.¹³

While FERC can be more proactive in fulfilling its “duty to eradicate unduly discriminatory practices”, as explained in response to question two in the NOI, the passage from Order No. 888 highlights the danger of making reliability dependent upon the voluntary actions of those whose interests conflict with open access and the development of robust competitive markets.¹⁴ Such is the current state of affairs with the existing regime of voluntary reliability organizations. The development of system adequacy and security standards consistent with commercial practices is central to completing the transition to competitive markets and the enhanced reliability they ensure.

The specific ways reliability is presently jeopardized primarily relate to the absence of standardized, uniform and enforceable procedures for calculating

generation, but instead attempt to reduce the ability of utilities to act on those incentives.” Order No. 2000 at 31,004.

¹³ Order No. 888, FERC Statutes and Regulations, Regulations, Preambles January 1991-June 1996 ¶31,036 at p.31,682.

¹⁴ The use of the word “voluntary” is misleading in one significant respect. The organizational framework for NERC’s operating policies, standards and procedures lacks an enforcement mechanism. Indeed, enforcement authority must be a key element of any reliability legislation, and explains the need for a more proactive role for FERC under these circumstances. In this sense, NERC is a “voluntary” organization. However, as a practical matter, utilities who virtually control the Regional Reliability Councils, and continue to exercise inordinate influence within NERC itself, impose requirements and rules on transmission customers—largely derived from the NERC process—in an inflexible manner. This forced compliance with transmission provider dictates, even though derived from a “voluntary” process at NERC, essentially amounts to “mandatory” rules for transmission customers, who must “take it or leave it” when it comes to transmission service.

total transmission capacity (TTC) and available transmission capacity (ATC), inconsistent and discriminatory application of NERC's transmission loading relief (TLR) procedures, utility gaming associated with the use of capacity benefit margins (CBM) and the failure to fully and properly implement the Open Access Same-Time Information System (OASIS).¹⁵ The harm caused by these problems is reflected in the exclusion of market participants from the bulk power system and the related distortions to the economics of the wholesale competitive market.

There is a growing concern in the competitive power supply industry that ATC calculation and posting—a critical feature of reliability--continues to be problematic. More than four years have elapsed since the requirement for OASIS and ATC posting was established in Order No. 889 in April 1996. Despite the work done by the “How and What” Working Groups before that date, NERC meetings continue to focus on the numerous unresolved ATC issues. All concede that ATC problems continue to hound the industry, making many OASIS sites difficult, if not impossible, to use. Continuing problems include:

- inconsistent path naming and valuations, making transactions through multiple control areas difficult;
- OASIS sites containing little or no useful information, with ATC calculations updated only twice a year;
- OASIS sites containing some useful data, but with sufficient elements missing to allow effective use;
- OASIS sites containing massive amounts of data, but very little useful information; and,

¹⁵ In its Supplemental Notice to Docket No. EL00-75 issued June 28, 2000, the Commission stated that its staff would perform an “extensive review and audit” of all OASIS sites to ensure compliance with OASIS regulations.

- OASIS sites containing inexplicable information, with ATC calculations varying wildly over short periods of time.

Indeed, a recently released FERC Staff Report on U.S. Bulk Power Markets¹⁶ highlights the seriousness of the problems caused by the lack of standardized ATC calculation and the inconsistent rules for posting ATC and CBM. FERC Staff also discussed the dangers posed by the increasing frequency of TLRs and the inadequate information supporting them. FERC Staff concluded that these defects threaten reliability by eroding confidence in the market, impairing market participants from entering business transactions, and discouraging needed infrastructure investments.

In short, while the goal of OASIS and the ATC requirement was to provide market participants with meaningful information about how the system was being used and how it could be used, the result has been far less than satisfactory. Any new mandatory reliability organization must remedy this problem.

2. What can FERC do under existing authorities to address reliability concerns?

EPSA believes that reliability policies implemented by jurisdictional utilities in a manner that modifies the rates, terms and conditions of service under the pro forma tariff must be filed with and approved by the Commission. This position is consistent with the Commission's statement that it must approve

¹⁶ Part II of the Staff Report to the Federal Regulatory Commission on Bulk Power Markets in the United States (Nov. 1, 2000).

“requirements and technical standards to ensure that they comply with the Commission’s comparable, open access policy.”¹⁷

The authority to approve tariffs setting forth rates, terms and conditions for interstate transmission service rests with the Commission alone. For Order Nos. 888 and 889, and 888-A, 889-A and 2000 to support the type of effective, robust competitive wholesale generation market envisioned by those orders, only the Commission can exercise final authority with respect to any operational, scheduling, reservation or curtailment requirements that affect the rates, terms and conditions of any service required to be offered under the tariffs.

Given their inescapable impact on the successful development of viable competitive power markets envisioned under the Commission’s open access transmission policy, reliability rules cannot become “extra-tariff” requirements, imposed on market participants, or otherwise supersede or modify tariff requirements, without regard for the Commission’s direct and exclusive jurisdiction over tariff issues. A transmission provider cannot be permitted to refuse to offer or to curtail a jurisdictional service provided for under a tariff (or threaten to do so) by invoking reliability procedures not contained in or even referenced in that provider’s tariff, even when doing so is arguably not in conflict with that tariff or the pro forma tariff.¹⁸ The fact is that imposition of the new

¹⁷ “Notice of Technical Conference and Clarification of Procedures for Developing Scheduling Requirements,” Open Access Same-Time Information System and Standards of Conduct, Docket No. RM95-9-003, (issued June 25, 1997).

¹⁸ The Commission addressed this issue indirectly in its November 25, 1997 Order conditionally accepting PJM’s open access transmission tariff and power pool agreements. Pennsylvania-New Jersey-Maryland Interconnection, 81 FERC 61,257 (1997). In that Order, the Commission declined to require that PJM Manuals be filed, but stressed that the PJM tariffs and rate schedules, not the PJM Manuals, define the rates, terms and conditions of jurisdictional service provided by PJM. The PJM-OI was directed to revise references to the PJM Manuals in the

“rule” would at least constitute an amendment to the terms of service and all such amendments must be approved by the Commission prior to their implementation.

Many reliability rules directly affect transactions subject to the Commission’s exclusive jurisdiction,¹⁹ for example, with respect to scheduling of transmission services, line loading, curtailment of service, or, ultimately, the rates for transmission services. And, in many instances, such reservation, curtailment or other rules presently are not in the transmission provider’s tariff or required by Order 888 and specified in the pro forma tariff. Accordingly, such requirements must be seen as effectively amending filed rate schedules (i.e. Order 888 compliance tariffs) without any filing or public notice. This contravenes both the Federal Power Act (FPA) and the Commission’s rules of practice and procedure.

In fact, if new reliability rules conflict with, or modify, the pro forma tariffs, they can only be imposed by the Commission after adequate notice and comment. Since Order Nos. 888 and 888-A do not permit unilateral modifications to the pro forma tariff, deviations from the tariff requirements must

various tariffs and agreements and to set forth the rates, terms and conditions in the PJM Manuals in the tariff as well. Id., PJM Interconnection, Docket Nos. OA97-261-000 and -001 and ER97-1082-000 and -001, et. al., (Nov. 25, 1997), mimeo at p. 18. See also Coalition Against Private Tariffs and Western Resources, Inc., 83 FERC ¶61,015, order on reh’g 84 FERC ¶61,059 (“...when changes in operating practices affect, for example, reservation, scheduling and curtailment provisions of the pro forma tariff, the changes need to be filed.” FERC relied on this order when requiring that TLR procedures be incorporated in OATTs (85 FERC ¶61,353).

¹⁹ Some reliability rules involve purely objective physical criteria and there would be little value to industry debate on these topics. Much more significant, however, is the “safety margin” associated with these physical values. Two immediate issues would be the adoption of overly conservative values which have the effect of removing valuable transmission capacity from the marketplace and the potential for inconsistent application of the margin values or unduly suppressing market clearing prices through forced surplus.

be filed and justified before being implemented.²⁰ In short, utilities, even at the direction of a national reliability organization, cannot substitute their judgment for that of an independent regulatory agency on matters squarely falling within the jurisdiction of that agency.

Section 205 (a) of the Federal Power Act provides that:

All rates and charges made, demanded, or received by any public utility for or in connection with transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

16 U.S.C. § 824d (a) (emphasis added). Moreover, Section 20 (c) of the FPA provides, in relevant part, that:

every public utility shall file with the commission...and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classification, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

16 U.S.C. § 824d (a) (emphasis added). The Commission has interpreted these provisions very broadly, to include the filing of “agreements or other arrangements involving the ... operation or use of facilities for the transmission

²⁰ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. 31,036 (Order No. 888), *clarified*, 76 FERC 61,009 and 76 FERC 61,347 (1996), *Order on Rehearing*, Order No. 888-A, (issued March 4, 1997), *Order on Rehearing*, Order No. 888-B, (issued November 25, 1997). At p. 398 (mimeo) the Commission allows a public utility to file tariff terms and conditions that vary from the pro forma tariffs, “provided that it: . . . (4) demonstrates that such terms and conditions are consistent with, or superior to those in the compliance tariff.”

or delivery of power at wholesale in interstate commerce,”²¹ ...or “any matter that forms any significant part of the calculation of the rate customers actually pay for jurisdictional service.”²² Accordingly, matters affecting jurisdictional services, such as reliability rules, ultimately must be subject to FERC’s notice and comment rulemaking or other authority, regardless of who designs them, and such rules cannot be imposed on transmission customers unilaterally, even if all industry sectors are represented by the private organization and concur with the policy.

Additionally, section 206 of the FPA empowers the Commission to remedy anticompetitive rates, charges, classifications rules, regulations, practices or contracts. Under section 206, the Commission, on its own motion or upon complaint, can investigate and determine the lawfulness of utility practices. Hence, section 206 provides legal authority for the Commission to fulfill its “duty to eradicate unduly discriminatory practices” inherent in existing voluntary self-regulation that threatens the development of competitive markets and reliability.

On balance, presently NERC’s reliability standards and policies directly affect transactions subject to the Commission’s exclusive jurisdiction regarding scheduling of transmission service, line loading curtailment and rates. In its Final Report, the Task Force on Electric System Reliability stated that

“because commercial and reliability interests are inextricably linked in the electricity industry, the Task Force urges the FERC to use its existing authority to regulate reliability matters that intersect with commercial markets to ensure nondiscriminatory

²¹ Prior Notice and Filing Requirements Under Part II of the Federal Power Act, 64 FERC ¶ 61, 139 at 61,986 (1993).

²² Id. at 61,988.

access to reliable transmission services until Congress takes action.”²³

EPSA agrees. Clearly, FERC’s tradition of deferring to NERC and largely remaining out of the “reliability business” is over.²⁴

3. If FERC has the authority to establish and enforce reliability standards, may FERC delegate such authority to a self-regulating reliability organization? Should it do so?

EPSA believes that a legal basis may exist for FERC to recruit a separate entity to assist it in the exercise of its authority founded upon an agency theory. Presumably, a federal agency can authorize a separate entity to serve as its agent in carrying out specific functions and activities. However, this would amount to something less than full-fledged delegation, which is constitutionally problematic. The unfettered exercise of authority transferred by FERC to an independent organization would constitute an unconstitutional delegation of FERC’s authority. Accordingly, the exercise of any authority to develop and enforce reliability standards by a separate entity—if at all possible--must be limited, clearly defined, and subject to FERC’s strict oversight and review.

4. Are there elements of the Comprehensive Electricity Competition Act, or other electric reliability legislative language, which can, with or without modification, be used in rulemaking?

A rulemaking need not, and should not, start from scratch. Reliability standards and related regulatory initiatives are having trouble keeping pace with the rapid evolution of competitive markets, creating uncertainty prolonging the

²³ Final Report, at xv.

²⁴ In fact, FERC has become more proactive with reliability enhancing initiatives. “Transmission system reliability is one of the principle issues sought to be addressed by the Commission’s recent rulemaking on Regional Transmission Organizations.” *Notice of Interim Procedures to Support Industry Reliability Efforts and Request for Comments*, Docket No.EL00-75, p. 2. Citing Order No. 2000.

transition period we are in. Legislative action may not occur for six months, or longer; however, system reliability—and the markets upon which it depends- are desperate for near term responsive solutions.

Title V of the Comprehensive Electricity Competition Act has been the subject of ongoing discussions by a broad-based stakeholder group that has produced industry consensus on fundamental issues. It would be useful and appropriate to use the broad outline of consensus as the basis for more a detailed rulemaking.

III. CONCLUSION

EPSA appreciates this opportunity to submit comments and applauds the DOE for focusing on these critical issues. EPSA members look forward to working with the DOE, FERC and all other industry stakeholders in taking the important steps necessary to transition to reliable and robust competitive electricity markets.