

New Proactive FERC

MEETING GRID RELIABILITY STANDARDS

BY WILLIAM F. HEDERMAN

▶ **THE GOVERNANCE SYSTEM** for power grid reliability in North America passed a major milestone on June 18 when reliability standards became mandatory for the first time. This is probably the most important development for U.S. power reliability since the formation of the North American Electric Reliability Council (NERC) in 1968.

The new standards have significant strategic and financial implications for electric utilities, merchant power companies, and all “entities” that must register with the new Electric Reliability Organization (ERO). In July 2006, the U.S. Federal Energy Regulatory Commission certified NERC as the ERO for the United States.

With regard to compliance, electric utilities have always treated reliability as a primary objective. Some have treated NERC’s reliability standards as “reliability suggestions.” Any new reliability standards will have the force of law and must be treated accordingly.

Under its chairman, Joseph T. Kelliher, FERC has made enforcement a major theme. Another FERC priority has been effective implementation of requirements under the energy act of 2005. FERC was the only federal agency to meet every one of its implementation deadlines in the act.

When an intergovernmental task force reported poor reliability readiness results after the power blackout on August 14, 2003, that affected the northeastern United States and Canada, FERC commissioners resolved to improve the system. When the energy act became law, Congress also armed FERC with mandatory standard authority and the power to impose penalties of \$1 million per day per violation for failures to comply with FERC’s regulations, whether market- or reliability-oriented. Through eight cases thus far, FERC has shown its readiness to impose multi-million-dollar fines for violations of administrative procedures, including instances that caused no market harm or were self-reported, despite full and sometimes “exemplary” cooperation by the offending entity. Power grid operators and users should expect much harsher treatment for reliability infractions, an area of special interest to Kelliher.

Many utilities were frantically scrambling to meet deadlines to comply with the new standards. The paperwork appeared to cause special problems. As one industry veteran put it, “We’re not so much concerned about making sure the lights are on. We are worried about whether we have submitted all the forms about keeping the lights on.”

The potential penalties raise interesting dilemmas for utility executives. Traditionally, much of NERC’s work has relied on “volunteers” from utilities. Can such volunteers participate in such serious regulatory matters as determining who may be subject to massive fines? Would persons who are being paid for their time

by their employer be considered volunteers if an entity that was fined appeals in court? Would a volunteer’s employer face exposure to risks of lawsuits or other actions?

As each utility and any other entity considers its strategic response to these mandatory standards, each market participant needs to be sure to analyze likely market effects of these standards. For example, price spikes in electricity markets have generally occurred because of tight supplies. Mandated reserves and related reliability measures are likely to have important effects on supply-demand balances. Strategic reassessments must take these new factors into account in market outlooks.

In addition, as industry executives proceed with their risk assessments, they need to appreciate the transformation at FERC, which aspires to be a “pre-eminent” enforcement agency, and at NERC, with new authority delegated from FERC. The relative passivity of compliance enforcement in the past provides no guide to the aggressive enforcement of the future. Not only will NERC as ERO have a compliance initiative, FERC is likely to pursue its own audits

and other enforcement actions both to assure itself that the mandatory standards are obeyed and to signal the importance FERC gives this new reliability regime.

Another important factor for those historically not subject to FERC is the significant expansion of FERC authority that Congress granted. If your organization participates in the wholesale transfer of electricity, you are likely to be subject to reliability regulation by FERC.

Wise corporate leaders will strive to create a culture of compliance and will expand the scope of this culture to include reliability standards. ☺

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