

Webcast: The New World of Mandatory Reliability Standards: Who The Standards Apply To and What Steps Should You Be Taking

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Moderator: Richard Meyer, Senior Regulatory Counsel, National Rural Electric Cooperative Association

ASSOCIATION OF CORPORATE COUNSEL

Moderator: Richard Meyer

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Operator: Just a reminder, today's conference is being recorded. Please go ahead, Tracey.

Tracey Steiner: Thank you (Sandy). Good morning and welcome everyone, my name is Tracey Steiner, I'm in-house counsel for the National Rural Electric Cooperative Association, and a member of the executive committee of ACC's Energy Committee. On behalf of the executive committee, I'd like to welcome you all to today's call, and thank you for your participation.

We're hopeful that this will be the first of a number of informative Web casts sponsored by the Energy Committee this year. We hope that if you have ideas for future topics, you will let us know what those are, and please, and you'll hear this reminder again later in the call, please fill out your evaluation forms and let us know what you thought of today's Web cast.

The evaluation form is located under the Links section on the left side in the middle, and it's the first document that you can select there. I'll give you just a brief overview of how the Web cast will run today. Our format is going to be about 20 minutes each for our two panelists, Mark Hagerle from the Federal Energy Regulatory Commission, and David Cook from the North American Electric Reliability Corporation.

Richard Meyer is going to be moderating today, and I'm going to introduce Rich, and then turn it over for him to introduce our two panelists. Rich is a colleague of mine here at the National Rural Electrical Coop Association. He is our senior regulatory counsel primarily responsible for representing NRECA before FERC. He served in that role since 1998, and has practiced energy law with a focus on FERC since 1979.

From '79 to '88 he was a senior legal advisor for two FERC chairmen, and also held legal positions within the rates and enforcement divisions at FERC. And from '88 to '98, he was in-house counsel at the Texas-based energy subsidiary for USX Corporation. So he's very familiar with a lot of the topics that we're going to be covering today, and that's why I implored him to help us out and moderate today's panel. Rich?

Richard Meyer: Well thank you, Tracey, and for everyone welcome to today's ACCA Energy Committee Web cast on the new world of mandatory reliability standards. We are particularly lucky to have Mr. David Cook and Mr. Mark Hegerle as our panelists today. They are preeminent experts in the field, and given how busy they are, we are very thankful for their participation.

Unless they would prefer to proceed otherwise, why don't we have Mr. Hegerle present first.

By way of introduction, Mr. Hegerle has been with the Federal Energy Regulatory

Commission for the past nineteen years.

He has served in a variety of capacities at FERC, helping to restructure both the electric and natural gas pipeline industries as a member of the technical staff, and as a technical advisor to former commissioner Nora Mead Brownell. He currently serves as the deputy director for reliability in the office of Energy Markets and Reliability.

Notably Mr. Hegerle also assisted in putting together the Energy Policy Act of 2005 during his detail to the office of U.S. Senator James N. Talent of Missouri, who served on the Senate Energy and National Resources Committee.

Mr. Hegerle is a Penn State graduate, is, he notes in his bio, happily married, and has three sons ranging in age from 10 to 15. Mark, why don't you go ahead and get us started.

Mark Hegerle: OK, glad to do that. Yes, I'm very honored to be able to say that there's at least one comma in EAct that's mine, but that's about it. So let's get rolling along here. OK, we don't need the introductory slide.

OK, what we're going to try to do today -- first, again I must say the usual disclaimer. I don't speak for the Commission or any commissioner, though much of what I say comes from orders that the Commission has issued, so it's trustworthy and reliable.

As far as today's topic, FERC's role in reliability, I understand that there may be a wide range of familiarity on the phone today, so I'll begin with an overview of legislation and the relevant Commission orders to date. I'll then our processes for standards approval and enforcement, followed by some issues and concerns that may be of more interest to the better informed in the audience.

OK, let me just introduce FERC's vision of reliability before we get started, the group that I help lead here. We began back at the time of the blackout in 2003. The Commission hired Joe McClellan as director, and we gathered the few engineers that we had on staff to consolidate into a division as of 2004. I think back then there were about 13 folks here. Now we're about 40, and we intend to grow to at least 50. There's a lot to do out there so we need lots of help.

Our general approach to reliability regulation, it needs to be proactive. I think it's pretty clear from the legislation that Congress doesn't want us to wait and just explain what happens, you know, why we had a blackout. They want us to set in place what's necessary to make sure that we don't have another blackout.

So I think that means that we're going to be involved in the ERO standards development processes, and we're going to be involved a lot in the audits and the committee meetings and everything. We're not just going to sit back and wait until the end and see what comes out of the processes that we'll describe in a bit.

The division of reliability doesn't stand alone at FERC in these responsibilities. The office of enforcement will have a large role with respect to compliance and enforcement matters. So we'll work very closely with Susan Court's shop there.

OK, on to EAct itself. Our formal beginning at FERC, our involvement in reliability dates back, of course, to August 8, 2005 when the president signed into law the first major energy legislation in over decade. And with the passage of EAct the commission was appointed the nations Federal Electric Reliability Regulator.

The commission's mandate from Congress was clear, as I said earlier. Establish a regulatory regime which will prevent cascading blackouts. Implicit in the mandate of course is the prevention of outages in large cities, you know. We'll get into that a little bit more later.

But while EAct identified a front-line entity for reliability, and that is the Electric Reliability Organization or ERO, to establish reliability standards and enforce them, it set the Commission as the regulator of the ERO. It gave the Commission authority to take direct action to insure reliability of the bulk power system.

I think these actions indicate that Congress should decide to move away from the voluntary regime that we had in existence before, and in a sense is still in existence now until the standards are approved, to one where the Commission insures not only compliance with the standards, but also continual improvement in reliability.

OK, our first big order to get the ball rolling on reliability was order number 672, which issued back in February, a year ago. The 672 implemented 215 and a later order, this order

on certification of the ERO, established NERC as ERO. What we get from that is that the ERO must submit reliability standards to the Commission for approval. And once they're approved, the standards are going to be enforced by the ERO subject to our oversight. OK.

The legislation mandates the Commission may approve a proposed standard if it determines the standard is just and reasonable, not unduly discriminatory or preferential and in the public interest.

And the Commission was pretty clear in Order 672 on the factors that it would consider when assessing whether or not a reliability standard is just and reasonable, and there's several. And I'll just walk through them quickly. A standard must provide for the reliable operation of all power systems, and it may impose a requirement on any user, owner or operator of the facilities on the bulk power system.

The standard must be designed to achieve a specific reliability goal, and must contain a technically sound means to achieve that goal. So it's got to be clear as to what it's trying to accomplish, so that those that are subject to it can understand what they've got to comply with. And there should be clear measures, as well, in the standard so that they know whether or not they're in compliance.

One of the important things that we put into Order 672 was that a reliability standard doesn't necessarily have to be the optimal method for achieving a reliability goal. It needs to accomplish the goal, but it doesn't have to be best practices.

The thing we wanted to avoid, however, is the opposite extreme, and that is having a standard that reflects the lowest common denominator. You know, we've got to remember that the goal is not merely standards that everybody can meet, but standards the bulk power system reliability.

One important note, I think, for today's audience is that a standard has got to take into account the size of the entity and the cost of the implementation. It's not just a here's what you have to do, we don't care what it costs or who you are. There's got to be some considerations in there. But again, it still has to protect the bulk power system reliability. That's the underlying fundamental there.

One thing that we were looking for is consistency. There are several regions with differences in the way they're structured, both corporately and physically across the nation. Nevertheless we're looking for a starting point being one set of standards. And then from that, deviations if necessary for things like terrain, or weather characteristics, or fuel types, ownership patterns, things like that, market design. But only after you have a base reliability standard to start from.

One other element in Order 672 was that a standard cannot have an undue negative effect on competition. You have to be careful that it's fair and balanced in that respect. And the Commission would have to be the judge of that. It's a competitive matter, not a reliability matter directly.

In that regard, the statute also says that the Commission needs to give due weight to the technical expertise of the ERO. We're not to just substitute our judgment to that for the

industry experts at the ERO. We need to oversee, but not to substitute our judgment.

There's a careful balance there.

OK, as I mentioned briefly a second ago, one of the more orders that we had was to certify an ERO. We're very glad that NERC applied to be the ERO. They are our only candidate, and they were well positioned to do the job as well. They had much in place for what was needed to develop standards and to enforce them.

One of the things that we're concerned about, however, is, like I said earlier, consistency. We're switching over from an establishment where the regions did most of the work, and the ER coordinator does efforts to one where the ERO is in charge.

When we certified ERO, the chairman, Chairman Kelleher, said there are three essential elements to a strong reliability regime. First he said that it's critical that the ERO be strong; second, that we need mandatory reliability standard that meet the statutory test; third, that we need strong and consistent regional enforcement.

We've got the -- OK. With respect to certification, to trying to achieve those goals, as you see on the screen the first was -- the element that we looked at was governance. We needed to make sure that the ERO was independent from the bulk power system users, owners and operators, and found that it was.

The ERO is governed by a board of trustees, and I'm sure David will get into that a little bit more later. Funding was a key issue. The ERO is funded by the rate payers, and allocate the

cost statutory activities based on analyses net energy for load, meaning the costs are shared by all who benefit by the reliability efforts.

Every year the ERO will submit a budget to the commission for review. And the key thing that we're looking for there is that only statutory activities are included in that budget. I'll talk about reliability standards development and enforcement in just a moment, but delegation agreements, I wanted to mention those as well.

The structure that the ERO has is a central ERO with regional entities to enforce the reliability standards more closely to the entities being, I guess you'd say, regulated. They've got to come before the Commission -- the ERO has got to come before the Commission with agreements to delegate its authority for compliance and enforcement. And those agreements are before us now, and we hope to issue an order shortly so that we will get the full ERO structure up and running.

OK. With respect to reliability standards, I think it's important to note it's the ERO that develops them and it's the Commission that reviews them to approve remand. Those are our choices, approve a remand.

This is very different from our section 205 authority which deals with tariffs, and services, and market rules and the like where we have the authority to essentially ask for a direct change, and explicitly explain and direct that change to a tariff or to a contract or service agreement.

The way the statute is written here is that we can approve it, a proposed standard. We can remand it if it doesn't meet the just and reasonable test that I explained a bit ago. Those are our choices. Alternatively, prospectively, we can tell the ERO, hey we've looked at the standards and we need a change, or we need a new standard. We have the ability to direct the ERO to write a standard, but not write it ourselves. That's what section 215 says.

OK. We usually will intend to use a rule-making process to act on filed reliability standards for the first batch. This began with a staff assessment back in May, 2006. The Commission staff issued an assessment of the proposed standards. We identified our preliminary observations and concerns regarding the then voluntary standards.

The assessment described issues that were common to a number of the standards, reviewed an identified issues, but it didn't make specific recommendations. That assessment led to comments being filed, which was followed up by a notice of proposed rule-making back in October where we proposed to approve 83 of the 107 reliability standards that were before us at that time.

The Commission described the NERC filings comprehensive and representing a significant effort by NERC, the industry and others in the standard development process. We believe that those standards would form a solid foundation on which development maintained the reliability of the bulk power system.

However we noted that much work remains to be done, and this is where I get back to the approved remand or direct change, that the Commission directed that 62 of the 83 standards

that it proved be prospectively revised, that it needed additional worker clarification, and made a proposal -- a specific proposal on changes that it would like.

Twenty-four of the 107 standards the Commission did not act on. Many of those are called what we call fill-in-the-blank standard, meaning that the regions had to add details to those standards, and had not yet done so. So we essentially set those on the shelf awaiting the necessary additional information before we act on them.

I think it's important to note that in that (noper), the Commission did not propose to remand any standers. So we know that they're in a state of transition, and that NERC has ongoing plans to improve them, and we look forward to that. I found it very important to get to a point where standards are mandatory and enforceable, if not perfect. We still found it to be in the range of just and reasonable, and worthy of approval.

OK. OK, rules that have little meaning if they're not able to be enforced, Order 672 also requires the Commission to periodically audit the ERO for ongoing compliance with the statutory and regulatory criteria. So we would audit the ERO itself to make sure it's doing the job that it promised to do when we said yes.

In addition, as I noted earlier, while the ERO is tasked with enforcing the standards, much of this responsibility will be delegated to the regional entities, thus the ERO will audit regional entity to insure it's adequately carrying out its responsibilities.

The Commission, in 672, said that we also will participate, we have the authority to either independently audit entities for compliance, or to essentially ride along with the ERO when they do their work. And I believe that we will probably do some of that.

The Commission kind of has three basic positions they can take in a compliance and enforcement duties. It can act like an appellate court really, and rely on the ERO RE's determination of standards violations and penalties, and just check them to make sure that all the processes were properly filed, or it can more aggressively oversee and audit the ERO's prophesies directly, or it can check the ERO by, as I said earlier, riding along and conducting independent investigations.

I think we'll end up somewhere in the middle where we do some spot checking. I think initially we will feel the need to be part of that process so that we can make sure that we support the ERO and keep it strong.

OK. Moving along here, just some other important issues. I noted earlier that we approved the ERO budget, and that we'll annually look at that. I think our concerns the first time around was really more, do you have enough money to do what you need to do. You have a big task.

Another thing we have done that's important is that we issued a staff assessment on cyber and physical security reliability standards. These are particularly important and wide-reaching, since the smallest of entities may be used as a portal to bring down the grid, and meeting these requirements may be costly. So that's going to be important to work through.

OK. A couple of questions I wanted to get into, to whom do the standards apply, bulk power system or bulk electric system? And who is the user, owner and operator? These questions are important because under the compliance and enforcement rules their penalty is up to \$1 million per day. So this matters now.

The basic question we face with both the bulk power system or bulk electric system is the statute uses the bulk power system, which is a more expansion definition of what falls under the reliability rules, whereas NERC has used historically in its definition a bulk electric system which is a little narrower.

So there's some things to be resolved in the final rule as to what's the correct definition and who is brought in as a user owner and operator. And if there's questions on that I think we can get into how where that falls out. I see I'm running a little low on time.

OK. Some concerns. I mentioned earlier that there's a concern about consistency. The mandatory standard represents a switch to a strong ERO model, with the ERO overseeing, rather than coordinating the efforts of the REs.

And it's going to take sometime for that switch to fully take hold. And so our job, I think, is to enforce -- to support the ERO and to make sure that it is taking the lead in making sure there's a consistency. I think they'll do a great job with that.

Another big question is with respect to remands and directives. As I mentioned earlier, our authority under 215 in some sense is less expansive than under 205. And there's a prescriptiveness issue.

If we tell the industry here's the standard we want to see, we get in trouble because we don't really have that authority. If we say that here's the general request, we may spend years going back and forth saying we can't accept that. We can't accept that. Likewise with Canada and Mexico with remands, if we remand something maybe they like it. Now how do we work that out?

And lastly, I'll close with one concern. Again, if we remand a standard or ask for a change, NERC takes that standard back, works on it with the whole ballot body, the whole voting membership.

If the voting membership can't produce, then come up with something that's satisfactory to the commission, what's NERC's authority to say no, that's not what the Commission said. We need to file something that they want. That is, I think, a big, unresolved question that we'll be working through in the coming days.

That wraps up what I had to say. I hope that was helpful, and I think we move now to David Cook for the NERC response.

Richard Meyer: Thank you very much, Mark. This is Rich Meyer. Before I introduce Dave, let me tell the audience how to enter a question. To enter a question, simply type the question in the lower left screen and hit Send. You can do this at any time. Again, to enter a question, type it in the lower left screen and hit Send. That's anytime.

And then after Dave is finished, we will then proceed to deal with the various questions. It's my great pleasure to introduce David Cook, who is Vice President and General Counsel of the North American Electric Reliability Corporation, or NERC.

He joined NERC's predecessor, the North American Electric Reliability Council in 1999, and led NERC's efforts to secure a passage of reliability legislation as part of the Energy Policy Act of 2005. Prior to joining NERC, he spent 20 years with the U.S. Federal Energy Regulatory Commission, the last ten as Deputy General Counsel.

Mr. Cook was heavily involved in the Commission's restructuring efforts for both the natural gas and the electric industries. Mr. Cook began his legal career in 1972 with the Chicago law firm of Schiff, Hardin and Waite, where he concentrated on commercial litigation, public utility law and industry's self regulation of securities markets.

He holds degrees from the University of Chicago Law School, the University of Chicago Divinity School, and Western Reserve University. We now turn our attention to Mr. David Cook.

David Cook: Thanks very much, Rich, and good morning everyone. Let me begin with some background information about NERC. NERC is a private non-profit corporation formed in 2006, whose mission is to improve the reliability of the bulk power system, that is the high voltage transmission system and the generation connected to it that services North America.

NERC's predecessor was the North American Electric Reliability Council, which was formed in the mid 1960s after the northeast blackout of 1965 to coordinate interconnected operations among utilities.

NERC has been certified by the Federal Energy Regulatory Commission as the Electric Reliability Organization under the legislation adopted in 2005, and has been given authority to develop and enforce standards for the reliable operation of the bulk power system. NERC is governed by an independent board of trustees.

The bulk power system is a very large and very complex machine that spans the international border. It must operate to a common set of rules as power flows back and forth across the borders. NERC provides a forum where interest from both sides of the border can come together to develop common solutions. NERC has eight regional affiliates, and many programs are carried out at the regional level.

NERC has dramatically broadened its membership. As the old NERC Council, NERC's members were the eight regional councils. With the new corporation, we now have over 500 members divided into 12 separate sectors as shown here on this slide.

Membership is open to all those with an interest in the reliability of the bulk power system in North America. The members elect a member representatives committee, which in turn elects the trustees, amends the bylaws jointly with the board of trustees and provides advice to the board on policy matters.

NERC operates in six program areas. Mark has talked a bit already about the reliability standards. NERC uses a consensus-based standards development process that brings the industry's technical expertise to bear on standards issues.

Our process has been accredited by the American National Standards Institute. We use a high quorum requirement, and a super majority voting requirement to assure that the standards have wide-spread support from among the industry participants.

Once we complete work on a standard, we submit it to FERC and other appropriate governmental authorities. Standards take effect in the U.S. only after they have been approved by FERC.

In Canada the situation varies from province to province. In Ontario, for example, our standards have legal force in the province once our board approves. Quebec has just adopted legislation that establishes a mechanism for reliability standards to become mandatory in that province. It will involve a rule-making proceeding before their Regie de l'energie.

In monitoring enforcing compliance is another key part of our activities. We expect that the regions will have the primarily responsibility for carrying out day-to-day compliance and enforcement activities subject to NERC oversight. NERC will delegate its enforcement authority to the regional entities, and NERC is seeking approval from FERC for the necessary delegation agreements.

Our rules of procedures and those of the regions contain detailed rules for how the compliance and enforcement program will run, including rules that assure notice and due process for any compliance proceeding.

The rules of procedure also include sanction guidelines that set out the range of penalties that may be applied for violations of the standards, and the factors to consider when making judgments about penalties.

Another key program is assessing and reporting on system adequacy. NERC assesses the adequacy of the bulk power system, both generation resources and the transmission system, and reports on the ability to meet forecasted loads.

Each year NERC issues short-term summer and winter assessments that focus on issues relating to the upcoming season. We also issue each year a ten-year assessment that focuses on longer-term trends and issues related to the adequacy of the bulk power system.

The reliability legislation in the U.S. specifically withholds authority for NERC to set enforceable standards for adequacy of the system. Instead we rely on the bully pulpit of our assessments to point out where problem areas are developing, and encourage others who have the authority to act, to take steps to deal with the situation.

We also are involved in maintaining situational awareness and critical infrastructure protection. NERC has the information sharing and analysis center for the electricity sector under the Department of Homeland Security initiatives, and similar programs in Canada.

NERC has developed extensive guidelines on various aspects of critical infrastructure protection.

We also work to improve the visibility that system operators have of events and conditions on the system in real time. A significant program that began after the August, 2003 blackout deals with evaluating the readiness of entities with responsibilities on the system. We've just completed the first three-year cycle of evaluating the preparedness of all system operators to meet their responsibilities under the reliability standards.

Using teams of industry volunteers, we want to make sure those with primary responsibility under the standards have the personnel, the tools and the procedures they need to carry out their responsibilities. Public reports of those evaluations are available on our Web site. We also look to identify and publicize examples of excellence so that knowledge and best practices can be more broadly shared among industry participants.

Finally, NERC conducts training programs on new standards, and we also evaluate training provided by others. And that training relates specifically to system operators as well as to others who must comply with the standards.

I want to focus more on one aspect of the compliance and enforcement program, and that's the compliance registry. We are developing a list of the specific organizations that we in the regions expect to hold accountable under the standards. Our goal is to have everyone who can have a material impact on the reliability of the bulk power system on the list. The list is still preliminary, but we currently have about 1,400 organizations on the list.

This slide gives a breakdown of those entities by region. It also identifies that many entities are registered for multiple responsibilities, that is someone like PJM may be registered as the reliability coordinator, and the transmission operator, and the balancing authority and perhaps some other functions as well. Our standards are written so that with an applicability clause it identifies which functions that particular standard applies to.

By the end of March we expect to send notices to all the entities on our list. Organizations will have the opportunity to challenge their being on the list. But at the end of the day that list is the ones that we will, and the regions will hold responsible for compliance of the standards. The list is not static. If down the line we find someone we think should be on the list, we'll add them, subject to their right to challenge.

This slide presents the compliance registry by the specific functions. It starts at the top with those with the most responsibility. All 17 reliability coordinators are on the list. All of the balancing authorities and transmission operators are also on the list.

As you move further down the triangle or pyramid, you get into entities that are perhaps smaller or in the past have had less contact with reliability standards. And it's in the lower part of this, I think, that Mark alluded to where there are some issues about who is an owner, operator and user of the bulk power system.

From our standpoint, we want to have a very clear list. We think that does two things. It provides due process in the sense that the entity will have notice, that it's on the list and what the expectations are. It also means that if we change a standard or we have a training program on a standard, we know exactly who to contact about that particular standard.

We think we have the balance about right now as to the entities that can have a material impact on the bulk power system being on the list, but that's something that only time will tell, as we move forward in implementing this.

My last slide contains information on how to get more information. Our Web site provides a great deal of information with links from our home page to each of the six major program areas. In addition, you can follow our progress in getting the Electric Reliability Organization up and running through the ERO implementation link on our Web page.

The home page also includes a link for becoming a NERC member. At this point I'm going to stop my formal presentation, and then look forward to answering questions. Thanks very much.

Richard Meyer: Thank you very much, Dave, and thank you, Mark. For today's listeners who are new to reliability and want to determine if the reliability rules apply or will apply to their company, what's the best place for them to start? Where should they go? These questions are directed either to Mark -- or directed both to Mark and Dave.

David Cook: I'll start, Rich. The compliance registry that I mentioned will be the definitive list from NERC's standpoint about who we expect to hold responsible. As I indicated, we expect notification to go out by the end of March to all of the organizations who are on the list.

We'll also be posting that list. So it will be available on our Web site. We'll be filing it with the Commission as well. That was one of the conditions to our certification is that we file our list with the Commission and update it on a regular basis. Until the notice goes out and the list becomes public, those with questions now can contact the Regional Reliability Council in their area, because we are working with those regions to develop the list.

I should say that, in the process of developing the criteria for the list, we have also spent a good deal of time working with the trade associations for the various organizations including NRECA, and APPA and EPSA, and EEI so that all of the associations could bring the concerns of their members to bear, and we can get a pretty solid list right out of the box.

Mark Hegerle: This is Mark. I would just say as well that's a difficult question. In 672 we acknowledged it. Generally a person directly connected to the bulk power systems selling, purchasing or transmitting electric energy over the bulk power system is a user of the bulk power system.

But we declined to adopt the formal definition largely because that's going to vary standard to standard. You know, we have those standards in front of us now that we're looking to get in place by the summer. But like we're implying, you may think you are not, but for some reasons you might be.

And one of those examples would be, as I alluded to earlier, if you have an internet link or some kind of a computer link to the system you might be a portal for someone trying to hack into the system, and controlling the system and possibly bringing it down. So while

you may think you're not all that important because you're a small entity, there may be ways that you are important and the standard would apply to you.

Richard Meyer: Following up on Mark's response, Mark, Dave said that you go to the compliance registry, and then you indicated that you may think you're not covered but you are covered.

I assume you agree with Dave that if you're on the compliance registry you're covered, if you're not on the compliance registry you're not covered until you are on the compliance registry. Is that correct?

Mark Hegerle: The standard should not apply to you? Is that what you mean by covered?

Richard Meyer: Yes.

Mark Hegerle: Yes. I think my understanding is that we would not enforce a standard against you, that's right, if you're not on the registry, because then you are not on notice that that would apply to you.

That's correct. I think if the Commission or NERC investigated that yes, you indeed did have a role in an incident or something, that that may bring you onto the registry at that point, again subject to appeal through the NERC process, and ultimately appeal to FERC. But yes, that's right.

David Cook: If I could just elaborate on what Mark said, it's, you know, if we come across an entity that's not on the list, the first thing we'll do is put them on the list. And at that point they

are subject to all of the standards. And they would be subject to, for example, directives for mitigation and to bring themselves into compliance with the standards from that point forward.

Mark Hegerle: So you may not be hit with a penalty for past actions, but you're going to be told here's what you need to do to get into compliance, prospectively.

David Cook: Exactly.

Richard Meyer: Mark, you mentioned, I hope I get the terminology correct, that if someone has a portal, a cyber portal, that they would be covered or may well be covered. That's something that's pending right now at the Commission. Isn't that correct?

Mark Hegerle: That's correct. NERC has filed standards for our review, and thus far we've just done a staff assessment with a notice of proposed rule-making coming in the near future. And we'll go through the same process as the first set of standards have gone through. But I think right now they're subject to -- we've actually received a couple of thousand pages of comments, and we're working through those comments now.

Richard Meyer: All right. Now Dave indicated that on the Web -- he gave some contact information for NERC, and that certainly people can use that. In general how would each of you like your organizations to be receiving questions from the various users, owners and operators? How would like those questions to come into you respective organizations? Could you expand that because I can't see the questions.

Mark Hegerle: Well I would say on the FERC Web site there's some links to Joe McClellan's name, our director. Or those questions, if they're informal in nature can be done through email that way to Joe or to myself. I would imagine that the wisest course of action is that they would start with, as Dave said, the regional entity who would know their situation more directly.

If a question from an individual came to us, we would have to do a very good research, and we'd probably go to the regional entity to start.

David Cook: I think that's right. Contact the regional entities, but if you just have a general question, if you'll send it to infoatnerc.com someone will follow up with you.

Richard Meyer: All right. We have a number of questions -- additional questions from the audience. First question is what roles or responsibilities do the regional ISOs have in this process?

David Cook: Well, they're system operators, very large ones, and so their first responsibility is to follow the rules that apply to them along with everyone else. The ISOs and RTOs are very active participants in the NERC processes, including standards development and so on, and we draw on them for technical expertise in our various programs.

There are a couple of the ISOs that are also regional or proposed regional entities. And indeed one of the questions pending before the Commission is, you know, to what degree a regional entity which will have delegated enforcement responsibility can also be an independent system operator or Regional Transmission Organization.

And in the Commission's implementing rule-making for the statute, the Commission said that it wasn't going to rule that issue out. That is it wasn't going to absolutely forbid that combination of functions. But I think its words were something like there would be a high hurdle to justify that kind of arrangement.

And the principle concern is a separation of functions responsibilities between those who have active responsibility for operating the system and those who are doing the sort of compliance monitoring and enforcement.

Mark Hegerle: That's right. I would agree with what Dave said.

Richard Meyer: We seem to have a lot of audience participation here. There is a two-part question that's been asked. In your views, what complexity will the inclusion of surplus power from cogeneration and distributed alternative generation create in determining the makeup of the registry? Is there a baseline that will be put in place to know if your business is to be included in that registry?

Dave Cook: It's largely a function of size. You know, if someone is operating a 1,000-megawatt cogeneration facility and putting 1,000 megawatts on to the system, they don't look any different than another large generator. And, you know, they would be on the list and be responsible for meeting the requirements.

As you get to smaller and smaller generators, you know, the question gets more interesting about whether they really have a material impact or not. Some -- a lot of the distributed

generation is really hooked onto a distribution system and not on to the bulk power system.

In general, the distributed generation that's behind a distribution entity is not likely to be included on the registry.

We submitted to the commission at the beginning of February a list of the criteria that we are using to put the registry together. That list of criteria is also available on our Web site. And it uses some rules of thumb about circumstances in which, for example, a generator or a smaller distribution system would be or would not be include on the list.

Mark Hegerle: Right. And I would agree with what Dave said, and add to that that there's difficulty in just having a blanket waiver, and the Commission stated that in its notice of proposed rule-making. Because a five-megawatt generator in the right place may have a huge impact on reliability, whereas as Dave said, if one's on the distribution system, well off the bulk power system, that same five megawatts may have little if any bearing on reliability.

So the Commission refrains from giving a blanket waiver, and as Dave said NERC did offer some things that we will consider.

Richard Meyer: In terms of the maximum penalties that can apply, how will NERC and FERC determine the penalties for standard and violations? That's an audience question.

David Cook: The statute provides for penalties up to \$1 million per violation, and it also states that each day that the violation continues can constitute a separate violation. As a part of the rules of procedure that we submitted with our application, we included sanctions guidelines.

And the guidelines contain a matrix under -- that sort of sets out how we'll look at getting to sort of assessing what their penalties should be.

Not all of the reliability requirements have the same level of risk to the system. If it's a high risk kind of requirement, the penalties can be higher for that kind of requirement. If it's a lower risk kind of thing, sort of administrative or documentation in nature, the penalties on that will be lower.

If it's sort of a repeat offender the penalties will be higher. If a company has a very good internal compliance program and evidence is a strong commitment to compliance, that's a factor that's taken into account in perhaps reducing the size of the penalty from what it might otherwise be.

Michael Hegerle: Yes, recently the Commission used it's civil penalty authority for some market cases. And the chairman was pretty clear about saying look, you know, we didn't impose the maximum penalty on these. We will if we have to, but we did not. If you self-report you get credit for that.

If the violation is egregious, you know, if you bring down New York City, OK, you're probably going to get a pretty stiff penalty, things like that. We're not going to hesitate to use the enforcement authority, but we're also going to be reasonable about it. We're going to try to resolve things through settlement as we're able to as well.

So the answer is that we don't know quite exactly yet how, but one thing as I mentioned earlier as well that we're going to be looking for, again it's going to be NERC that proposes the initial penalty, and we'll review it.

And we'll be looking just like a, you know, college football game. You know, referees in the SEC should identify and penalize holding the same way in the big ten as they do in the PAC-10s. We'll look for that, that each region is treated the same way. We're not going to be tough just to be tough. We're going to make sure the penalty is -- you know, you're deserving of the fines you get.

Richard Meyer: Dave had mentioned a reliable compliance plan, and Mark, you referred to that Commission meeting where I know the commissioners each referred to the importance of compliance plans.

As people are developing their reliability compliance plans, do you all have any suggestions as to what those compliance plans should look like?

Dave Cook: It gets into -- it's a fairly expanded question, and rather than deal directly with that let me just say that I have participated in several workshops over the last two or three months, some in Washington, some other places where people are spending considerable time just going through what those kinds of internal compliance programs would look like.

But, you know, in very general terms they tend to be identifying a senior officer with compliance responsibility, and making sure that the accountabilities are aligned with that,

and that the responsibilities of who has to -- who has responsibility within the organization for assuring compliance are in place.

And in that respect my guess is it's similar to the kinds of internal compliance programs that people have put in place for OSHA violations and for EPA violations, those kinds of things.

Mark Hegerle: Yes, I think that's right. Compliance is an expensive proposition. There's money at stake when you devote resources to reliability. And I think we'll be looking for a proactive and the accountability that Dave described as well, that folks are not just kind of hoping that things are going to well, but that they're going to be constantly checking.

This can be a systematic approach to looking to see are we in compliance, not just a let's-wait-and-see approach.

Richard Meyer: Thank you. We've been talking about compliance programs and how penalties are determined. I guess a basic and close to final question is when are these rules enforceable?

David Cook: Mark mentioned that the commission is on the verge of completing it's final rule under reliability standards. The Commission has a meeting in mid-March. They haven't announced a public agenda for that meeting yet. But we are anticipating that the final rule on some fair portion of the reliability standards will be acted on at that meeting, or perhaps shortly after that.

If that happens, then there's some, you know, some sort of notice requirements and so on in the statutes and so on that have to take effect before the -- have to be observed before the rules can actually take effect.

But I think people are looking to have -- anticipating that there will be sort of final standards in place, delegation agreements to the regions approved so their enforcement mechanism is in place by the summer.

Mark Hegerle: Yes, the chairman's been very clear that's been his goal all along is to make it by summer as Dave -- Dave and I talked ahead of time. He's at a lot more liberty to talk about dates and speculate because that's what he's doing on the outside. But I can't do that here. The Commission will act when it acts. But again, it's shooting for the summer.

There's a fair bit of notice time involved with Congress, the I think, 60 legislative days that they have to have it before it can go into effect. So, you know, in a sense, do the math, back up from the summer, and you're looking at about when we have to do it to meet that schedule. So was June 1 the right day, you know, I don't know. It might be June 20th, or the 5th, or July 1st. June 1 will be a great date to have it ready if we can make that.

Richard Meyer: Well gentlemen, you've done a terrific job. You've answered the various questions that have been submitted, and our questions as well. Before we wrap up, is there anything you would all like to add?

David Cook: Well I appreciate the attention to these issues. It's something that NERC identified a long time ago as the need to get mandatory reliability standards in place. And we're just very encouraged that we're now on the verge of having that happen.

Mark Hegerle: And I would just add that I appreciate the ACC putting this together. There's a lot of education that has to occur both in terms, as we were talking, as to who it applies to and how you get involved. I'm sure Dave would join me in saying that you need to be involved with the NERC processes to make sure the rules turn out the way you believe they need to be.

Tracey Steiner: Great. Well we'll let that be the final word. I want to thank you both also. We really appreciate you taking your time. We know you have very busy schedules right now, and there's a lot going on this time of year. So thank you very much for taking the time to help get that educational message out.

I'd just like to remind everyone on the call that we would really appreciate your filling out the evaluation form for this Web cast. Again, it is available under the Links section, that's in the middle of the page on the left-hand side. Please fill that out and return it to us.

And again, if you have other topics that you would be interested in seeing the Energy Committee take up in a future Web cast, please submit those to us. And with that I'm going to turn this back over to (Sandy) to wrap up our call today.

Operator: OK, thank you very much, Tracey, and with that we will end our call today. Thank you very much for everyone on behalf of ACC. You may now disconnect.

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