



## OVERVIEW OF ERO FINAL RULE Order No. 672

- On August 8, 2005, EPAct was enacted into law, establishing a new section 215 of the Federal Power Act to provide for a system of mandatory, enforceable reliability standards. Under the new electric power reliability system enacted by the Congress, the United States will no longer rely on voluntary compliance by participants in the electric industry with industry reliability requirements for operating and planning the Bulk-Power System. Congress directed the development of mandatory, Commission-approved, enforceable electricity reliability standards.
- The Commission will certify a single Electric Reliability Organization (the ERO) to oversee the reliability of the United States' portion of the interconnected North American Bulk-Power System, subject to Commission oversight. The ERO will be responsible for developing and enforcing the mandatory reliability standards. The Reliability Standards will apply to all users, owners and operators of the Bulk-Power System. The Commission has the authority to approve all ERO actions, to order the ERO to carry out its responsibilities under these new statutory provisions, and also may independently enforce Reliability Standards.
- The ERO must submit each proposed Reliability Standard to the Commission for approval. Only a Reliability Standard approved by the Commission is enforceable under section 215 of the Federal Power Act.
- The ERO may delegate its enforcement responsibilities to a Regional Entity. Delegation is effective only after the Commission approves the delegation agreement. A Regional Entity may also propose a Reliability Standard to the ERO for submission to the Commission for approval. This Reliability Standard may be either for application to the entire interconnected Bulk-Power System or for application only within its own region.
- The ERO or a Regional Entity must monitor compliance with the Reliability Standards. It may direct a user, owner or operator of the Bulk-Power System that violates a Reliability Standard to comply with the Reliability Standard. The ERO or Regional Entity may impose a penalty on a user, owner or operator for violating a Reliability Standard, subject to review by, and appeal to, the Commission.
- On September 1, 2005 the Commission issued a NOPR that proposed regulations regarding certification of the ERO, development of Reliability Standards, enforcement of Reliability Standards, delegation of authority to Regional Entities,



## OVERVIEW OF ERO FINAL RULE Order No. 672

ERO funding and other matters necessary to implement the statute.

- The Commission adopts a Final Rule that generally follows the approach of the NOPR, based on careful consideration of the comments submitted in response to the NOPR, with some modification. We note that numerous commenters express support for the NOPR and believe that the proposed regulations establish the framework for an effective ERO, as intended by Congress.
- The Final Rule is generally limited to developing and implementing the processes and procedures that section 215 of the FPA directs the Commission to develop and undertake with regard to the formation and functions of the ERO and Regional Entities. Section 215(b) obligates all users, owners and operators of the Bulk-Power System to comply with Reliability Standards that become effective pursuant to the process set forth in the statute. The Commission recognizes the critical need for an ERO that is effective in developing and enforcing mandatory Reliability Standards.
- The Commission believes that, to achieve this goal, it is necessary to have a strong ERO that promotes excellence in the development and enforcement of Reliability Standards. Accordingly, various provisions of the Final Rule are intended to set out the ERO's role and responsibilities with respect to the users, owners and operators of the Bulk-Power System. The Final Rule requires periodic review of the ERO and Regional Entities to ensure that the statutory qualifying criteria are maintained on an ongoing basis.
- The Final Rule requires the ERO and Regional Entities to provide mechanisms to achieve effective and fair Reliability Standards. A Reliability Standard should not reflect the "lowest common denominator" to achieve a consensus among participants in the ERO's Reliability Standard development process. The Commission will carefully review each Reliability Standard submitted and, where appropriate, remand an inadequate Reliability Standard to ensure that it protects reliability, has no undue adverse effect on competition, and can be enforced in a clear and even-handed manner. Further, the Final Rule allows the Commission to set a deadline for the ERO to submit a proposed Reliability Standard to the Commission to ensure that the ERO will revise in a timely manner a proposed Reliability Standard that is not acceptable to the Commission.



## **OVERVIEW OF ERO FINAL RULE Order No. 672**

The major provisions of the Final Rule are as follows:

### **1. ERO CERTIFICATION**

- The Final Rule provides that the Commission will, after notice and opportunity for comment, certify one applicant as the ERO. The Final Rule sets forth the criteria that an ERO applicant must satisfy to qualify as the ERO, including the ability to develop and enforce Reliability Standards.
- To ensure that the ERO complies with the certification criteria on an ongoing basis, the Final Rule requires the ERO to undergo a performance assessment three years after certification and every five years thereafter. The ERO must file a self-assessment with the Commission explaining how it satisfies the ERO requirements. Regional Entities, users, owners and operators of the Bulk-Power System, and other interested entities will have an opportunity to make recommendations for the improvement of the ERO. After receipt of the performance assessment, the Commission will establish a proceeding in which it will assess the performance of the ERO. The Commission will allow opportunity for public comment. As a result of the performance assessment, the Commission will issue an order either finding that the ERO meets the statutory and regulatory criteria or directing the ERO to comply or improve compliance with the statutory and regulatory criteria for the ERO. Subsequently, if the ERO fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order, including, if necessary and appropriate, a proceeding to consider decertification of the ERO.
- The ERO submission must include an evaluation of the effectiveness of each Regional Entity. The Commission will, as part of its proceeding to assess the ERO's performance, assess the performance of each Regional Entity and issue an order addressing Regional Entity compliance. If a Regional Entity fails to comply adequately with the Commission order, the Commission may institute a proceeding to enforce its order, including, if necessary and appropriate, a proceeding to consider rescission of the Commission's approval of the Regional Entity's delegation agreement.

### **2. ERO AND REGIONAL ENTITY FUNDING**

- Section 215 of the FPA generally provides for Commission authorization of funding for statutory functions, such as the development of Reliability Standards



## OVERVIEW OF ERO FINAL RULE Order No. 672

and their enforcement, and monitoring the reliability of the Bulk-Power System. The Final Rule clarifies, however, that while the ERO or a Regional Entity is not necessarily precluded from pursuing other activities, it may not use Commission-authorized funding for such activities.

- The Final Rule directs ERO candidates to propose a formula or method of funding addressing cost allocation and cost responsibility, along with a proposed mechanism for revenue collection for Commission consideration. The Final Rule finds that funding based on net energy for load is one fair, reasonable and uncomplicated method that minimizes the possibility of “double-counting.” However, the Commission does not rule out other apportionment methods that can be shown to be just and reasonable.
- As the primary entity responsible for the development and enforcement of Reliability Standards, the ERO must fund the delegated statutory functions of the Regional Entities and approve their budgets, under the Commission’s general oversight. The Final Rule requires periodic financial audits to ensure that any ERO-approved funding is appropriately expended for delegated functions. It addresses concerns that a significant amount of the ERO’s or a Regional Entity’s total revenue from an alternative source for non-statutory functions could compromise the mission or independence of the ERO or a Regional Entity.
- The Final Rule provides that the ERO should include line item budgets for the activities that it delegates to each Regional Entity. The Final Rule permits the ERO to request emergency funding on a demonstration of unforeseen and extraordinary circumstances.

### 3. RELIABILITY STANDARDS

- The Final Rule implements the new Federal Power Act provisions relating to development of Reliability Standards by the ERO. It establishes the ERO as the only entity that can submit a proposed Reliability Standard to the Commission for approval.
- The Final Rule determines that the ERO’s Reliability Standard development process must provide for reasonable notice and opportunity for public comment, due process, openness and balance of interests. The Commission observes that an American National Standards Institute-accredited process is one reasonable means of satisfying these requirements.



## OVERVIEW OF ERO FINAL RULE Order No. 672

- The Commission may approve a proposed Reliability Standard (or modification to a Reliability Standard) if it determines that it is just, reasonable, not unduly discriminatory or preferential, and in the public interest. In its review, the Commission will give due weight to the technical expertise of the ERO. However, the Commission will not defer to the ERO with respect to a Reliability Standard's effect on competition.
- The Commission seeks as much uniformity as possible in the proposed Reliability Standards across the interconnected Bulk-Power System of the North American continent. The Final Rule permits a regional difference in a Reliability Standard, in particular for a regional difference that is more stringent than a continent-wide Reliability Standard, including a regional difference that addresses matters that the continent-wide Reliability Standard does not, and a regional difference necessitated by a physical difference in the Bulk-Power System. The Commission would generally find acceptable a proposed regional difference that satisfies the statutory and regulatory criteria for approval of a proposed Reliability Standard and that is more stringent than a continent-wide Reliability Standard.
- The statute requires the ERO to apply a rebuttable presumption to a proposal for a Reliability Standard from an Interconnection-wide Regional Entity to be applicable within its Interconnection. The Final Rule clarifies that this rebuttable presumption refers to the burden of proof. Thus, if the ERO does not find that the presumption for a proposed Reliability Standard is adequately rebutted, it must accept it as just, reasonable, not unduly discriminatory or preferential, and in the public interest, and submit it to the Commission for approval.
- Section 215(d)(6) of the Federal Power Act requires the Commission's Final Rule to include "fair processes for the identification and timely resolution of any conflict between a Reliability Standard and any function, rule, order, tariff, rate schedule, or agreement accepted, approved, or ordered by the Commission applicable to a transmission organization." Accordingly, the Final Rule provides a process for a user, owner or operator to notify the Commission of such possible conflicts for timely resolution by the Commission.
- Further, the Commission interprets section 215 as generally permitting a state to take action, as long as such action is not inconsistent with a Reliability Standard. If an alleged inconsistency is brought to the Commission, the Commission will require that a petition for determination of inconsistency be served on the relevant



## OVERVIEW OF ERO FINAL RULE Order No. 672

state agency, and will consider the recommendation of the relevant state and the ERO.

### 4. ENFORCEMENT OF RELIABILITY STANDARDS

- The ERO is responsible under section 215(e) of the FPA for ensuring that all users, owners and operators of the Bulk-Power System comply with Reliability Standards. In addition, the statute provides that the Commission can, independent of the ERO, investigate compliance with a Reliability Standard and impose a penalty for a violation. The ERO may delegate its enforcement responsibilities to a Regional Entity. The Final Rule sets forth various elements of the enforcement process, including (1) the ERO and each Regional Entity is expected to have a compliance program that includes proactive enforcement audits to determine if users, owners and operators are complying with Reliability Standards; (2) the ERO and the appropriate Regional Entity will conduct investigations of alleged violations of Reliability Standards, and the ERO must inform the Commission promptly of these investigations and their disposition; and (3) the ERO or a Regional Entity may assess a penalty (non-monetary or monetary), subject to Commission review.
- The Final Rule requires the ERO to develop an enforcement audit program. In addition, any Regional Entity that receives a delegation of enforcement function should also have an audit program. The Final Rule explains that there should be a single audit program applicable to both the ERO and Regional Entities unless there is a compelling reason for a difference between the ERO and a particular Regional Entity.
- The Final Rule implements the enforcement provisions of section 215(e) of the FPA, which authorize the ERO to impose a penalty for a violation of a Reliability Standard, subject to Commission review. The enforcement provisions allow the ERO or a Regional Entity with delegated enforcement authority to impose a penalty on a user, owner or operator of the Bulk-Power System for a violation of a Reliability Standard. The ERO will retain oversight responsibility for enforcement authority that is delegated to a Regional Entity. To ensure consistency in the implementation of delegated enforcement authority, a Regional Entity must report periodically to the ERO on how it carries out its delegated enforcement authority. The Final Rule makes clear that the ERO and Regional Entities must establish uniform rules that provide adequate due process to an alleged violator when the ERO or Regional Entity is determining whether to assess



## OVERVIEW OF ERO FINAL RULE Order No. 672

a penalty. The Final Rule concludes that, to provide adequate due process yet prevent duplicative and unnecessary expenses, there should be a single opportunity for appeal before the matter is referred to the Commission. Further, the Final Rule establishes expedited procedures for Commission review of a penalty, as required by EPCRA.

- The Final Rule discusses the ERO's and a Regional Entity's ability to take remedial action separate from its penalty authority. For example, the ERO or a Regional Entity may direct a user, owner or operator to come into compliance with a Reliability Standard.
- The Final Rule requires the ERO to notify the Commission promptly of a self-reported violation or an investigation into a violation or alleged violation and its eventual disposition. This will allow the Commission to receive timely information on a violation or alleged violation of a Reliability Standard and determine whether Commission action is appropriate.
- The Final Rule requires the ERO to develop, and submit to the Commission for approval, penalty guidelines that identify a range of non-monetary and monetary penalties to be applied by the ERO for determining the appropriate penalty for violation of a Reliability Standard. Regional Entities must adopt the ERO's penalty guidelines with change only as necessary to reflect regional differences in Reliability Standards.
- The Final Rule finds that an investigation conducted by the ERO, a Regional Entity, or the Commission of a violation or an alleged violation of a Reliability Standard will be nonpublic unless the Commission authorizes a public investigation. However, once the ERO or a Regional Entity imposes a penalty and files the statutorily-required "notice of penalty" with the Commission, the Commission will publicly disclose the penalty. The Final Rule includes an exception to this public disclosure with respect to Cybersecurity Incidents and other matters that would jeopardize system security.

### **5. DELEGATION TO A REGIONAL ENTITY**

- The Final Rule establishes criteria for the ERO to delegate authority to a Regional Entity to enforce Reliability Standards and to propose Reliability Standards to the ERO. It sets out the role of a Regional Entity in relationship to the ERO, concluding that the ERO holds the primary responsibility for enforcement of



## OVERVIEW OF ERO FINAL RULE Order No. 672

Reliability Standards and that any delegation of this responsibility to a Regional Entity is subject to ERO oversight.

- The Commission explains the process and criteria for becoming a Regional Entity. The Final Rule relies on statutory criteria for evaluating a Regional Entity applicant. Each application will be evaluated on a case-by-case basis. The Final Rule establishes a rebuttable presumption afforded to a proposal for delegation to a Regional Entity organized on an Interconnection-wide basis. This rebuttable presumption is that such a proposed Regional Entity promotes the effective and efficient administration of Bulk-Power System reliability. The Final Rule adopts a periodic Regional Entity performance assessment process administered primarily by the ERO.
- The Final Rule addresses the subject of uniformity among delegation agreements. It emphasizes the value of uniformity and requires the ERO applicant to submit a *pro forma* delegation agreement concurrently with its ERO application. The Final Rule allows a prospective Regional Entity to submit a delegation agreement directly to the Commission if good faith negotiations with the ERO fail. The Commission strongly urges a prospective Regional Entity to consider the use of alternative dispute resolution (ADR) to resolve any dispute over the terms of the delegation agreement. The Final Rule requires a prospective Regional Entity that submits a delegation agreement directly to the Commission to state whether an ADR procedure was used and whether the Regional Entity believes that ADR under the Commission's supervision could successfully resolve the disputes regarding the terms of the delegation agreement. The Commission may, if appropriate, upon review assign the ERO's authority to enforce reliability standards directly to a Regional Entity.
- The Final Rule clarifies that a Regional Entity should not directly submit a Regional Entity Rule or change to a Regional Entity Rule to the Commission because this is consistent with the role of the ERO overseeing the Regional Entities, as discussed below. The Final Rule directs the ERO to develop procedures and criteria by which a Regional Entity Rule or change to Regional Entity Rule will be judged by the ERO, and then be submitted to the Commission for approval.
- The Final Rule provides for the establishment of Regional Advisory Bodies. It observes that it would generally be desirable to have a Regional Entity and a Regional Advisory Body cover the same region but does not require a Regional





## OVERVIEW OF ERO FINAL RULE Order No. 672

Advisory Body and a Regional Entity to have a common boundary. The Final Rule finds that section 215 of the FPA permits a Regional Advisory Body to form even if there is not yet a Regional Entity in a region, in part so that a Regional Advisory Body may advise the Commission and the ERO regarding the governance of a proposed Regional Entity.

### **6. ENFORCEMENT OF COMMISSION RULES AND ORDERS**

- The Commission generally expects to work cooperatively with the ERO and Regional Entities to resolve issues that may arise. Nonetheless, the Final Rule clarifies the Commission's authority to take action against the ERO or a Regional Entity for non-compliance with section 215 of the FPA. The Final Rule provides that the Commission may take such action as is necessary and appropriate against the ERO or a Regional Entity to ensure compliance with a Reliability Standard or any Commission order affecting the ERO or a Regional Entity. As a final resort, the Commission may suspend or rescind the ERO's certification or a Regional Entity's delegated authority.
- The Final Rule establishes the policy that, in general, the Commission oversees the ERO and the ERO oversees any approved Regional Entity. Consistent with this approach, the Final Rule provides that the Commission may periodically conduct a compliance audit to examine the ERO's compliance with the statutory and regulatory criteria for becoming the ERO and performance in enforcing Reliability Standards. The ERO must periodically audit each Regional Entity's compliance with relevant statutory and regulatory criteria for becoming a Regional Entity and performance in enforcing Reliability Standards and report the results to the Commission.
- Although we would expect to use this provision only in extraordinary circumstances, the Final Rule allows the Commission to impose civil penalties on the ERO or a Regional Entity. The Final Rule does not provide for the assessment of a monetary penalty against a board member of the ERO or a Regional Entity.