

**Skadden**

## **Phase II of Reliability Enforcement**

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- **Phase “Zero” – establishing the reliability enforcement program**
- **Phase I – initial enforcement of the standards**
- **Phase II**
  - What programmatic changes should we expect from NERC or FERC?
  - What other developments are on the horizon?
  - Should the industry pursue reforms?
    - Consistency
    - Ambiguity
    - Backlog
    - Documentation

- **Developing the reliability enforcement regime**
  - Order Nos. 672 and 693
  - Certifying the ERO
  - Delegating enforcement authority to the regions
  - Creating a uniform compliance monitoring and enforcement program
  - Creating violation risk factors and severity levels
  - Adopting an initial six-month “grace period”

➤ **Phase I: Initial Implementation**

- Thousands of self reports were submitted prior to June 2007
- The six month “grace” period resulted in mostly zero penalties, although only a fraction of the cases have been completed
- Most large entities have been audited
- FERC has commenced CVIs regarding several disturbances
- The enforcement backlog has grown and shows no signs of shrinking
- There has been a continuing debate over whether to release the nonpublic “penalty tool”
- There has been an increase in formal “interpretations” submitted to address ambiguities arising in enforcement cases

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- **What changes (if any) can we expect in the next year or two?**
    - There have been growing pains and there is growing frustration within the industry
      - Aggressive enforcement of ambiguous standards
      - The enforcement backlog
      - Minimal transparency as to the violations that are occurring
      - Concerns over the value of self-reporting and compliance programs
    - Will the new players make a difference?
      - A new FERC Chairman, new Commissioner and new NERC CEO
      - A new FERC Enforcement Chief and General Counsel
    - Coming opportunities for programmatic change:
      - FERC: the three-year assessment
      - NERC: renegotiation of the delegation agreements
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- **Predictions?**
  - **Most indicators suggest FERC will not pursue programmatic changes in reliability enforcement on its own**
    - FERC is busy with other things
    - Initial comments on the three-year assessment support the status quo
    - Reliability continues to have “motherhood and apple pie” qualities – i.e., everyone wants strong enforcement
    - Congress continues to watch FERC closely in this area
    - Some problems are beyond FERC’s control – i.e., they require reforms from NERC or the regions
  - **But the changes in FERC leadership make this hard to predict**
    - The new leadership may want to signal change to a more “balanced” enforcement program
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- **One area that is most likely to receive attention by FERC: how to handle ambiguities in the standards?**
    - This issue is at the center of several nonpublic investigations
    - The FERC has two main options: address the ambiguities in pending enforcement actions or in a generic proceeding
      - FERC may seek settlements that have aggressive mitigation that is aligned with staff's interpretations
        - However, mitigation plans can be expensive and some targets may resist adopting mitigation plans that validate disputed staff interpretations
      - The FERC may also address recurring ambiguities in orders issued *sua sponte* or in the context of reviewing standards or formal interpretations

➤ **Will NERC push for any significant changes to the CMEP?**

- This depends in part on the new NERC CEO
- The three-year assessment does not propose sweeping changes; however, it does suggest NERC may pursue changes when renegotiating the delegation agreements in 2010
- NERC’s April draft assessment stated that “the time has come for all compliance programs to report to independent directors”
  - This change would be controversial
- The final assessment recommended that “efficiency could be gained by . . . formally engaging NERC enforcement staff much earlier in the process.”
  - Some argue that NERC (and FERC) are already too involved
  - The debate over the fate of the “delegated model”

- **The FERC is likely to announce settlements or orders to show cause in its nonpublic investigations**
  - These will be the first cases with significant civil penalty amounts under Section 215
  - They may include mitigation plans that address ambiguous standards
  - They are likely to increase, not lessen, the industry's angst over the direction of the reliability enforcement program
- **FERC will also be asked, for the first time, to review settlements coming from the regions that have material civil penalties**
  - To date there have been no cases with penalties over \$300,000
  - This is in contrast to the civil penalties in other FERC cases
  - FERC may seek to rationalize these differences over time

- **As the industry considers its reform agenda, it should bear in mind the complexity of the key problems**
  - In many instances, fixing one problem simply creates another
- **Two examples**
  - The desire for “consistency”
  - The problem of “ambiguity”

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- **One of the industry's top priorities has been consistency in enforcement across the eight regions**
    - This is a laudable goal and it is one that FERC shares, but it comes with a cost – actually, three of them
  - **To achieve consistency in regional enforcement, you need three things:**
    - Effective **oversight** by NERC and FERC, which means these entities must play a more active role than they otherwise would
    - Adequate **documentation** to perform that oversight role, which means more paperwork than would otherwise exist
    - Adequate **time** for NERC and FERC to review this documentation, which means a slower process than would otherwise occur
  - **What is the answer?**
    - Consistency is not a goal that should be pursued in isolation
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- **The industry is understandably concerned that FERC is pursuing enforcement of ambiguous standards**
  - **However, there is some tension in two related arguments on this issue**
    - The industry has sought greater compliance guidance (e.g., through no action letters, RSAWs) to help reduce the potential for violations
    - The industry has also argued, however, that FERC and NERC cannot “interpret” a standard outside the formal interpretation process
  - **What is the answer?**
    - There is no easy answer that solves both
    - One option: NERC and FERC provide greater compliance guidance (i.e., are not limited to the formal interpretation process), but their guidance is applied only prospectively (and is subject, of course, to appeals)
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- **Reducing documentation burdens**
    - NERC's assessment recommends reducing documentation burdens (e.g., by removing documentation requirements from the standards)
    - FERC may be sensitive to this problem because of the backlog and may be willing to reconsider its July 3 Order that increased these burdens
  - **Greater transparency**
    - One byproduct of the backlog is that there is very little information on the nature of the violations that are occurring
    - NERC provides a list of the “top ten” most violated standards, but there is little other information available
    - It should be possible to aggregate data on the reasons why certain standards were violated without revealing any case-specific information