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Remarks of
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Federal Energy Regulatory Commission

"Remarks on Reliability and the Restructuring Agenda"

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I.

I am pleased to be able to visit with NERC's Board of Trustees today. I want to take 15 minutes of your time to say some things that need saying. From the Commission's standpoint, this is an important and even historic moment in the evolution of this industry. For years, our spheres of influence and authority have been remarkably separate, despite our mutual interest in the quality and reliability of bulk power service, despite the national scope of both of our activities and responsibilities, and despite the interconnectedness of

economics and reliability. Reliability has always been important to us but the Commission has had little role, and less authority in this area. Kevin Kelly and others on our staff (Pat Rooney, Paul Robb, Don LeKang) have bridged that gap quite well, hopefully to the benefit of both NERC and the Commission. Let me express my thanks for your receptivity to their presence and their input.

As I noted in my February letter to you, however, legislation, market developments, and the mutually-acknowledged need to advance electric restructuring and the cause of reliability make it appropriate for us to be exploring what other processes might be helpful. I still await your suggestions about institutional arrangements for a future FERC/NERC relationship, although I want to recognize the helpful talks that Gary Neale and I have already had, largely as a matter of

contingency planning if the Congress does not help us define that relationship.

At the risk of restating the obvious, I want to recount why both your organization and ours need to more formally acknowledge our role in reliability. Believe me, we would not invite federal regulation into this area without the industry's assent or a firm belief that the Commission can play a constructive role in helping ensure reliability. I nevertheless view the situation this way:

! Notwithstanding the fact that the Commission has traditionally had no reliability authority or responsibilities, or a budget to deal with such issues, the commercial significance of new reliability measures have required us, within a relatively short time, to:

-- approve transmission line loading relief procedures and e-tagging;

-- approve WSCC's reliability management system;

-- act on NERC's Market Redispatch Program, Next Hour Market filing, and a request to clarify the business practice standards for OASIS transactions.

-- approve ECAR's Inadvertent Interchange Settlement Tariff.

! Threats to system reliability in the past two years (and the potential for an adverse public reaction to electric restructuring) led the Commission to issue its May 17, 2000 order to support various measures that may shore up the system this summer.

- FERC also finds itself involved in the current legislative debate over the future administration of bulk power reliability in this competitive environment. And we have largely supported NERC's proposals.

If anyone doubts that NERC's reliability struggles are also genuine matters of public policy that implicate the Commission, its resources, and its future role in the power market, consider the issues raised just within the past week:

- What should be the standards of functional or corporate separation of Security Coordinators, Control Area Operators, and other operating authorities from wholesale or retail merchant functions?
- What is the appropriate role (if any) of RTOs in the development and enforcement of reliability standards –- under Order No. 2000

and under any new reliability legislation? How are the roles of RTOs and NERC distinct and are RTOs subordinate to NERC and the regional councils? Or are we aiming at some level of integration of the two?

! And, if legislation does not pass and the nature of the successor to the NERC structure does not become obvious this year, what interim options are appropriate and what role can FERC play, especially given Congress' implicit unwillingness to give it an expanded role in reliability formally?

It becomes clearer to me as time passes that reliability and market functions are not separable. No piece of stand-alone reliability legislation, however meritorious, entirely gets us where we need to go. We need open, competitive, transparent markets too and I,

for one, do not think that will happen without RTOs. The focus of RTOs on transmission should incent investors to expand the system and give other investors in generation confidence that they will be able to connect to the grid. None of this means that I subscribe to the view that RTOs necessarily become regional reliability organizations or that they should be allowed to set standards wholly independent of NERC. But, I do believe that neither the NERC's reliability policies nor FERC's market competition policies will succeed unless they compliment one another and move forward together.

Now, let me be more specific about how that might -- or might not -- happen and what the reliability challenges are, from a FERC perspective.

First, NERC's agenda directly affects the Commission's agenda and its workload. Moreover, the NERC process for developing standards is still subject to challenge from within the industry. In other words, decisions may be both negotiated at NERC and then litigated at FERC. Since this seems inefficient to me, I would ask, Is there a way to resolve these disputes earlier?

Second, both NERC and the Commission gather data on the industry and wholesale market transactions. There is some significant duplication. Should we think about working from a common data base, gathering data one time and sharing them?

Third, both of our organizations are concerned with preserving an appropriate reliability role for states. They need to be able to address supply adequacy issues

and emergency problems, because states are admittedly on the front line if the lights go out. Equally important, the Commission has actively sought greater state-federal cooperation on a variety of issues involved in the current transition to competition. However, the draft savings clause that NERC very recently sent to the Hill after a negotiation with other parties is not altogether workable, in my estimation. Since I have had little time to express myself on this matter, let me explain.

Essentially, my concerns are twofold. Inviting states to make bulk power reliability decisions is unacceptable. In the past, very few states have had any interest in directly managing the short-term reliability of the grid within their states even in emergencies.

Yet, the overbroad language of the proposed savings clause seems to do just that by making state reliability measures immune from most limits in federal law. Only an "inconsistency" with a NERC standard would transgress the proposed provision. I recognize that that issue can be adjudicated by the Commission. However, I would point out that it is not clear that the Commission can act in areas of state reliability activity that are not covered by a NERC standard or that reflect state requirements over and above NERC's.

Second, and harkening back to my earlier point that system reliability and market economics are becoming inseparable, the Commission is left powerless by this provision to reject state reliability measures that may be not just and reasonable, that are unduly discriminatory or preferential, or that are otherwise not in the public interest. We should not invite

continued balkanization of the nationwide grid by up to 48 sets of rules of the road.

In other words, I would have appreciated greater input to this process. If asked, I would be hard pressed to support such a provision. I believe, and let me be fair but clear, that this draft legislation would not have come from NERC if NERC had given the Commission the same level of consultation and support that the Commission has given NERC.

Fourth and finally, let's collaborate on the future of regional market institutions. ISOs already exist. RTOs are on the way and in great numbers. Order No. 2000 implementation is high on our agenda and it should be high on yours. At the inception of this restructuring process and as possible conflicts arise

between NERC and RTOs, I want the Commission more involved in developing solutions.

These are critical issues to the Commission. We want to support NERC's efforts and, even more than that, bulk power reliability. I doubt we can do either effectively from the sidelines. Implementation of Order No. 2000 and the proposed new legislation are the tests of whether NERC and the Commission can forge a closer, more effective partnership.

I look forward to your suggestions about where we go from here.

Thank you.