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Energy Policy Act of 2005 Gives Teeth to Electric Reliability Rules

New Reliability Organization(s) and FERC Gain Broad New Authorities

Summary

The Energy Policy Act of 2005 ("05 Act"), signed into law by President Bush on August 8, 2005, amends the Federal Power Act of 1935 ("FPA") to provide for expansive, new mandatory and enforceable electric reliability standards for the interstate bulk power system, with the Federal Energy Regulatory Commission ("FERC") having jurisdiction over all users, owners, and operators of the bulk power system to enforce compliance. Since 1968, the North American Electric Reliability Organization ("NERC") and its regional reliability councils have maintained reliability of the interstate electric transmission system largely through a voluntary, industry-based process. The new law's reliability provisions provide for FERC to certify an Electric Reliability Organization ("ERO") with authority to develop and enforce reliability standards, subject to FERC review. It is likely that NERC will be accepted as the ERO.

ERO To Be Independent; Impose Dues, Fees, and Other Charges; and Develop Standards and Penalties

The new ERO will be certified by FERC to establish and enforce reliability standards for the interstate bulk power system. Among the rights and responsibilities conveyed to the ERO are:

(1) an obligation to maintain independence from the users, owners, and operators of the bulk power system while assuring fair stakeholder representation on its board of directors;

(2) the right to charge and collect fees, dues, and charges from end users to pay the ERO's administrative costs;

(3) a duty to promulgate reliability standards after notice and opportunity for public comments and subject to FERC approval; and

(4) the authority to impose penalties for violations of reliability standards, also subject to FERC review.

It is widely expected that NERC will seek certification as the ERO. The ERO may delegate its authority to develop and enforce reliability standards to a regional entity if the regional entity meets the same criteria as the ERO, except that the regional entity may be governed by an independent stakeholder board or a balanced stakeholder board or some combination of the two. The statute does not prescribe a minimum size or scope

requirement for the regional entity, except to call it "regional." It is likely that the existing regional reliability councils will seek and obtain delegation agreements with the ERO.

FERC Gains Broad Jurisdiction Over Bulk Power System Reliability

The 05 Act gives FERC jurisdiction over all users, owners, and operators of the "bulk power system," including traditional utilities, power marketers, independent power producers, and utilities not otherwise subject to FERC jurisdiction (i.e., municipals, cooperatives, federal Power Marketing Authorities, the Tennessee Valley Authority, and utilities within the Electric Reliability Council of Texas). The "bulk power system" is defined to include the interconnected transmission network as well as "electric energy from generation facilities needed to maintain transmission system reliability." The term "reliability" is defined to include cyber security incidents affecting the grid. FERC is otherwise expressly denied jurisdiction over generation facilities, and it remains to be seen how far FERC will move beyond traditional generation-related reliability issues such as voltage control and operational reserves. In this connection, the 05 Act does not give FERC authority over the adequacy of generation or transmission capacity, and it cannot require the construction or enlargement of transmission or generation facilities.

In addition to its oversight of the ERO, FERC has the explicit authority to impose penalties if FERC finds that a user, owner, or operator of the bulk power system has engaged in or is about to engage in any act that constitutes or will constitute a violation of a reliability standard. FERC may impose civil penalties of up to $1 million per day for each day a violation of any provision of the FPA continues. Criminal penalties and jail sentences are also available.

As a result, FERC gains authority over a broad subject area as well as the authority to impose penalties for an act that has not yet been committed. The ERO, and regional entities by delegation from the ERO, also have authority to impose penalties, subject to FERC review, but only for actual violations. It seems likely that penalty or enforcement actions for reliability violations will generally originate in the ERO or the regional entities.

States Retain Role in Ensuring Electric Reliability: New York Given Special Status

The 05 Act contains a savings clause to protect the rights of states to take actions to ensure the reliability of electric service within their state so long as the action is not inconsistent with a reliability standard promulgated by the ERO or FERC. In addition, the State of New York is granted special status that allows it to establish its own reliability rules so long as those rules provide for greater reliability within the state and do not result in lesser reliability outside of New York.

Implications and Opportunities

The 05 Act represents a sea change in the way in which reliability standards for the bulk power system are developed and enforced. The combination of the ERO with its statutory mandate, authorization to charge fees, and independence requirements, and FERC's central role in all aspects of reliability portend new challenges for all owners, operators, and users of the interconnected transmission system. The 05 Act provides the electric utility industry and other interested parties with an opportunity to help develop some of the important details about how the new reliability regime will be administered. FERC is required to implement the new reliability provisions of the FPA through a rulemaking within 180 days of enactment. Some of the issues that may be resolved in the course of the rulemaking are: the membership structure and dues for the ERO and the regional entities; the scope of regional variation in reliability standards; the scope of the ERO's oversight and control of the regional entities; the payment and collection of fees to the ERO; and important procedural requirements and standards for enforcement.

Other Reliability-Related Provisions in the 05 Act

- FERC is authorized to issue permits for the construction or modification of transmission facilities in areas designated as "national interest electric corridors" where, among other things, congestion is a problem. National interest electric corridors will be designated by the U.S. Department of Energy ("DOE") after input from interested parties, regional reliability entities and states, based on DOE's determination that such areas are

experiencing transmission capacity constraints or congestion that adversely affects consumers.

- FERC shall encourage advanced technologies that increase capacity, efficiency, or reliability of new or existing transmission facilities, including energy storage devices, controllable load, distributed generation, mobile transformers, and mobile substations.
- FERC shall issue a rule promoting capital investment to enlarge, improve, maintain and operate transmission facilities; provide a rate of return that attracts investment in transmission; and provide for recovery of costs of complying with mandatory reliability standards.
- FERC and DOE must conduct several studies to determine, among other things: (1) the benefits of using mobile transformers and substations to rapidly restore electrical service after equipment failure, natural disasters, acts of terrorism, or war; (2) the potential benefits of distributed generation; (3) the effects of electrical contaminants on reliability of energy production systems.

For more information concerning the new reliability provisions in the 05 Act, as well as the many other subjects addressed by the new law, contact Hunton & Williams through one of the attorneys listed on the “Contacts” section of this Client Alert.