

**Prepared Remarks of John Q. Anderson
Chairman of the Board of Trustees
North American Electric Reliability Corporation
July 6, 2010 Technical Conference**

Good morning, Mr. Chairman and Commissioners.

My name is John Anderson, and I am Chairman of the Board of the North American Electric Reliability Corporation. I was elected in 1999 as an independent trustee of NERC's predecessor, the North American Electric Reliability Council, as that organization began its transformation to the electric reliability organization that NERC is today. I want to thank you for this opportunity to take a step back and focus on the broad policy underpinnings of how we as the ERO, you as the governmental authority with oversight responsibility in the United States, and those with an interest in the bulk power system together go about this business of reliability.

NERC's single mission is to ensure and enhance the reliability of the bulk power system of North America, to the benefit of citizens in both the United States and Canada. Our reliability standards, the compliance and enforcement programs that we and the regional entities carry out, our critical infrastructure protection program, our event analysis and lessons learned, our assessments of near-term and long-term reliability and issues that affect it, our certification and training programs, and our situation awareness program are all directed to that end.

These are challenging times to be regulators. I'm sure you at FERC are feeling that, as are we at NERC. We are strongly committed to working with you through the special role we play in the U.S. as the designated Electric Reliability Organization, or "ERO". Recently we've seen too many examples of regulatory missteps and regulatory failures for anyone to feel complacent about being a regulator: The Massey coal mine explosion in West Virginia, the BP oil well disaster in the Gulf of Mexico, the financial crisis with subprime mortgages and derivatives, and the Bernie Madoff Ponzi scheme. We recognize and understand that this is the background for discussions about how NERC and the Commission are together implementing section 215 of the Federal Power Act.

NERC, working with stakeholders, the regional entities, the Commission and its staff and their counterparts in Canada have made major progress in the standards area since the blackout of 2003 and the passage of the Energy Policy Act of 2005. We now have a full set of mandatory and enforceable standards in place in both the U.S. and most provinces in Canada. In particular, we have standards for vegetation management and relay loadability (both of which were major factors in the 2003 blackout), and we have a baseline set of critical infrastructure protection standards, something that exists for no other sector. These standards, along with all of the other tools and processes, including enforcement mechanisms, we have in place for reliability, work to reduce the risk of widespread cascading failures of the bulk power system by heading off problems before they occur, enabling prompt recovery if something does happen, and providing ways for NERC and the Commission to take corrective action as necessary.

We recognize we have more work to do. Recent changes within NERC will improve efficiency, timeliness and accountability for producing standards and for responding to directives from

governmental authorities. We are committed to those changes and to improving our standards effort.

We believe that Congress got the standard-setting roles right when it outlined the requirements for the ERO model in the Energy Policy Act of 2005 and Section 215. The ERO model provides the opportunity to engage many hundreds of industry subject matter experts, along with other stakeholders such as large and small customers and governmental authorities with expertise on the “receiving” end of reliability, in developing standards that best serve the reliability of the bulk power system in North America. Reliability does not come without cost and other tradeoffs, and the crucible of the standard-setting process is the place where the reliability gains, the reliability costs, and other factors in this complicated system can best be evaluated.

The ERO model also provides the opportunity to recognize that the interconnected bulk power system is international in scope. The bulk power systems that span the U.S.-Canada border are very large, very complex machines that must operate to a common set of rules. Under the ERO model, interests from both countries can come together in a single forum to develop common reliability solutions, which can then be taken back to their respective regulators for the approvals needed to make the standards mandatory and enforceable. In 2005, the U.S. Department of Energy and the Canadian Federal/Provincial/Territorial Working Group endorsed principles for an electric reliability organization that can function on an international basis. NERC followed those principles in developing its governance structure and standards development procedures. I’ve attached a copy of those principles because they help to put this discussion in proper context.

Finally, the ERO model provides for strong government oversight. No standard can take effect in the U.S. without the approval of the Commission. No enforcement action can take effect without the approval of the Commission. The ERO model offers the best opportunity for the Commission and other governmental authorities to participate in shaping appropriate priorities for future standards activity. The ERO model also provides the Commission with independent enforcement activity.

The recent Commission order directing NERC to modify its standards process to allow the board to respond to regulatory directives presents a complex situation because developing standards under Section 215 requires a balancing act: the expertise is in the industry and we need to encourage continued participation; NERC’s standards process has been accredited by the American National Standards Institute and we believe that brings significant value in the form of industry buy-in to the outcome of the standards (to date, there has been only one very recent court appeal of NERC’s reliability standards); and the success we have had in gaining Canadian support for the NERC standards has much to do with the opportunity Canadian interests have had to participate directly in standards development through NERC. Further, unlike the Commission, NERC does not enjoy sovereign immunity for the consequences of its actions. To make up for that, we rigorously follow a standards development process that has been accredited as meeting ANSI’s standards-setting requirements.

My colleagues on the NERC board and I have had long and serious discussions about what course we might take in response to the Commission’s order. No one questions that the

Commission has the authority under Section 215 to direct the ERO to develop a reliability standard that addresses a specific matter if the Commission considers such a standard appropriate for reliability. The question has been how to do that in a way that continues to meet the requirement in Section 215 that our standards process continue to provide for reasonable notice and opportunity for public comment, due process, openness, and balance of interests and that it continue to provide for Canadian participation in a manner that assures acceptance of NERC's standards in the Canadian jurisdictions. I can tell you that the board is evaluating its oversight of the standards process, and I expect a more active role for the board in ensuring accountability in the standards process going forward.

At this juncture, what we believe is needed is open communication between NERC and the Commission, and with stakeholders, at all levels, staff and senior leadership. We need fruitful discussions about what are the key policy issues and goals, about what is working and what is not working, what are the priorities and the timing expectations. One of the things we heard from our stakeholders as we prepared our three-year performance assessment was that we had too many "priorities". Or, as one stakeholder put it, "if everything is a priority, then nothing is a priority."

One topic where such dialogue is clearly called for is what is meant by reliable operation, as that term is used in Section 215. The NERC standards have been written and implemented to prevent widespread, uncontrolled cascading outages and long-term damage to equipment, and to permit prompt restoration in the event a disturbance does occur. Recent orders from the Commission appear to indicate a paradigm shift, from one of preventing cascading outages and equipment damage to one where there are no outages, regardless of scope or location. If that paradigm shift is in fact what the Commission intends, then NERC and the Commission and the stakeholders need to first engage in serious policy discussion. As I said, the current standards were written to deal with cascading outages and their consequences. The current system has been designed and built and is operated based on that paradigm. A change to a "no outages" paradigm would likely require a revisiting of the standards and would certainly require substantial additional investment.

I again want to express, on behalf of myself and the NERC board, my appreciation for the Commission opening this discussion. I look forward to the rest of the discussion today. More importantly, I look forward to exploring with you ways to have these discussions continue as we work together for the reliability of the bulk power system of North America.

August 3, 2005

**PRINCIPLES FOR AN ELECTRIC RELIABILITY ORGANIZATION THAT CAN
FUNCTION ON AN INTERNATIONAL BASIS**

The Bilateral Electric Reliability Oversight Group (“Bilateral Group”) which is comprised of representatives from the U.S. Department of Energy (DOE), the U.S. Federal Energy Regulatory Commission (FERC), the Federal-Provincial-Territorial Electricity Working Group (FPT Group) in Canada, developed draft principles for an Electric Reliability Organization (ERO) for comment by stakeholders.

Based on the comments received from stakeholders at workshops the FPT Group and DOE endorse the attached principles. These principles are intended to guide the establishment of a reliability organization that can function effectively in the U.S. and Canada. There will be a need to explore other issues as the reliability organization evolves over time.

PRINCIPLES

Governance of the ERO

- The ERO Board of Trustees (the Board) should maintain independence from the electric utilities and entities that own, operate or use assets comprising the North American bulk power system.
- Regulatory authorities or government representatives should not appoint members or be appointed to the Board.
- Each country participating in the ERO should have the opportunity to have Board members from that country. The number of Board members from each country should be in approximate proportion to that country's percentage of Net Energy for Load. However, where the number of Board members from that country would be less than 25 percent of the Board, the number of Board members allocated to that country should not be less than the percentage of its Net Energy for Load.
- Each country should have the opportunity to have an equitable number of members from that country on all ERO committees, in approximate proportion to that country's percentage of Net Energy for Load.
- An organization applying to become the ERO should take appropriate steps to gain recognition in Canada at the same time the application for ERO status is filed with FERC, and in Mexico as appropriate.

Membership

- All owners, operators, or users of the North American bulk power system must comply with the approved reliability standards, regardless of whether the entity is a member of the ERO.

- Membership in the ERO should not be a condition for participation in the ERO standards development process.

Funding

- “Net Energy for Load” should be the primary basis upon which the costs of the ERO are assigned. Costs incurred for one region or entity may be directly assigned to that region or entity.
- Funding mechanisms, budget direction and budget level should reflect consultation with stakeholders and the appropriate authorities in each country.
- The appropriate authorities in each country should be responsible for approving and ensuring cost recovery by the ERO and Regional Entities within their respective jurisdictions, in a timely manner.

Remand

- The ERO should consult with the appropriate authorities in each country with regard to reliability standards under development, to minimize the likelihood of a remand being exercised.
- If a standard is remanded by a regulatory authority, the ERO should notify all relevant regulatory authorities, and should work to ensure that all concerns of such regulatory authorities are addressed prior to the resubmission of the standard to FERC and authorities in Canada.

Enforcement

- The appropriate authorities in each country should have the option of either enforcing standards directly or relying on the ERO or the respective Regional Entity to which enforcement has been delegated.
- Compliance with reliability standards should be monitored and evaluated.
- All confirmed violations of such standards should be promptly reported to the relevant regulatory authorities by the ERO or Regional Entity.
- Throughout the ERO, the penalty should be similar for a particular violation and set of circumstances, and should be the same within an interconnection regardless of where the violation occurred or who set the penalty.
- The penalties should be sufficient to maintain reliability and corrective action should be sufficient to ensure that reliability of the grid is restored.
- The ERO should be notified of any enforcement actions taken by a Regional Entity.
- Dispute resolution procedures should be established within the ERO for issues arising from alleged standards violations.
- Violations of ERO and Regional Entity standards should be made public.

Audits

- The ERO and Regional Entities should conduct rigorous audits to ensure both the capability to comply (Readiness Audits) and actual compliance with reliability standards (Compliance Audits). The audits should meet relevant auditing standards.
- The ERO should take steps to ensure that auditors are properly trained and that the same audit standards apply to all audits conducted by the ERO and Regional Entities.

Regional Entities

- When considering the delegation of authority to a proposed Regional Entity, the ERO, FERC and regulatory authorities in Canada should take into consideration whether the size or scope of the proposed Regional Entity would result in difficulty in conducting cross-border trade.
- A Regional Entity that has cross-border scope should ensure that each country represented in the region has the opportunity to have members from the country on the Board in numbers that reflect the country's approximate percentage of its Net Energy for Load in that region.
- Where possible, the boundaries of Regional Entities should encompass boundaries of other transmission organizations, such as Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs).
- Regional Transmission Organizations and Independent System Operators should not become Regional Entities. The Regional Entity should be distinct from the operators of the system, such as RTOs and ISOs.
- If stakeholders serve on the governing bodies of Regional Entities, no single sector should be able to veto and no two sectors should be able to control the outcome of a particular decision, where sector voting is used.
- The ERO should have the authority to oversee implementation of standards within regions to ensure that such implementation is sufficiently stringent and compatible with ERO standards.
- The ERO should ensure that regional standards do not compromise the reliability of interconnected neighbouring regions.