

WHEN SHOULD THE FERC DEFER TO THE NERC?

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Synopsis: There is significant tension between the Federal Energy Regulatory Commission (FERC or Commission) and the North American Electric Reliability Corporation (NERC) over the development of reliability standards. In March 2010, the Commission issued nine orders that reflected deep dissatisfaction with the manner in which reliability standards were being developed. This article examines two recurring legal issues presented by these orders: (i) the extent of the FERC’s authority to require changes to a reliability standard; and (ii) the level of deference the FERC should give to the NERC in reviewing its proposed standards.

This article surveys the history of tension between the FERC and the NERC, and considers comparable areas of the law that provide a broader perspective on these two issues. The article then concludes that the FERC should begin a transition to a posture in which it focuses primarily on setting broad policy objectives for the reliability issues of greatest importance to the nation, rather than continuing to order hundreds of individual changes to the NERC’s proposed standards. This approach will focus the FERC’s scarce resources on the tasks of greatest importance, will increase the NERC’s independence by allowing it more discretion in developing individual standards, and will maintain the benefits of a stakeholder-driven standards development process. The article also recommends that the FERC provide greater guidance on the deference that it will give the NERC when reviewing individual standards and, specifically, that the FERC defer to the NERC if it has provided a rational basis for a proposed standard, even if the FERC would have reached a different outcome considering the matter *de novo*.

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I. INTRODUCTION

The electric reliability program is at a crossroads. In March 2010, the FERC issued nine orders that taken together could be interpreted as a vote of no

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confidence in the self-regulatory model administered by the NERC—and, in some respects, the NERC itself. The FERC found, *inter alia*, that the NERC was not complying with FERC directives (either by failing to implement them or being too slow in doing so) and, in addition, proposed to remand a NERC standard, overturn a NERC standards interpretation, and redefine the boundaries of the Bulk Electric System.

This article addresses two related issues that underlie this conflict. The first is the extent of the FERC's authority to prescribe specific changes to a reliability standard. The Federal Power Act (FPA) section 215(d)(2)-(4) gives the FERC authority to approve or remand a proposed standard, but not to rewrite it;¹ however, section 215(d)(5) gives the FERC authority to require the NERC to “propose[] . . . a modification to a reliability standard that addresses a specific matter.”² The question, in harmonizing these provisions, is how far the FERC can (or should) go in prescribing *how* a “specific matter” is addressed.³

The second, and closely related, issue is how much deference the FERC should give to the NERC when reviewing proposed reliability standards. Section 215(d)(2) requires that the FERC give “due weight to [the NERC's] technical expertise,” but there is little guidance as to what this means.⁴ The absence of guidance is a growing concern as the FERC tightens its oversight of the NERC's standards development process. This issue is also closely related to the first issue because each time the FERC orders a standard modified under section 215(d)(5), it has essentially chosen not to defer to the NERC's determination that the standard was acceptable as written.

What should the FERC do in resolving this conflict? On the one hand, there are institutional prerogatives and political pressures that will continue to push the FERC in the direction of attempting to assert control over the standards development process. On the other hand, if the FERC goes too far it will undermine the strength of the NERC and marginalize the self-regulatory model adopted in section 215.

There are no easy answers for the FERC, but I would offer the following two related recommendations. On the first issue, I would suggest that the real issue is one of policy and institutional deference, not one of law. The FERC recently “acknowledged that it lacks authority to prescribe the specific content of a Reliability Standard.”⁵ That holding is laudable and correct as far as it goes, but will prove an empty gesture if the FERC continues to use its section 215(d)(5) authority to order changes to most reliability standards. I recommend that the FERC move away from this approach, and begin a transition to using its authority to set broad policy objectives and priorities - e.g., requiring action in an area not yet covered by the reliability standards, or identifying major flaws in existing standards. The FERC's credibility and influence are at their zenith when the agency sets broad policy objectives and allows the industry leeway to develop the implementation details. Conversely, the FERC's influence and stature declines when it is viewed as constantly arm-wrestling the NERC and

1. 16 U.S.C. § 824o(d)(2) (2006).

2. *Id.* § 824o(d)(5).

3. *Id.*

4. *Id.*

5. *N. Am. Elec. Reliability Corp. (NERC)*, 132 F.E.R.C. ¶ 61,218 at P 27 (2010).

industry stakeholders over the details of most reliability standards. The FERC's recent decision to hold period technical conferences on critical policy issues should provide a platform for a transition to a more active role in guiding policies and priorities, and hopefully this can be coupled with a more deferential role as to how those policies are implemented.

This leads me to my second conclusion - namely that the FERC give greater deference to the NERC and, in particular, to its consensus-based process for developing reliability standards. The FERC has been reluctant to grant such deference to date because it does not seem to trust stakeholder voting to develop the standards. But, as the comparable literature on judicial deference shows, there is nothing wrong with and there is every reason to defer to, a consensus-based process that balances multiple competing objectives - e.g., strengthening *reliability* at a reasonable *cost* in a *pragmatic* manner that provides *clarity* for compliance, and also *flexibility* to the diverse types of registered entities. There will be times when the process fails to reach rationale outcomes, but the process itself is not flawed simply because it does not resemble Albert Einstein alone in his study constructing the theoretically optimal solution. There is no single, perfect solution to most problems in the real world.

What is meaningful deference in this context? In my view, it is a standard that requires the NERC to adopt rational outcomes that are adequately explained, but once it does so, the FERC should not substitute its judgment for that of the NERC. That is the essence of deference, and is no different than what the FERC expects of the judiciary. If the FERC rationally balances competing objectives in adopting policies to strengthen competition, allocate costs, and remedy undue discrimination, then courts are not supposed to impose their own policy preferences on the FERC. Similarly, if the NERC provides a rational explanation for a proposed standard, the FERC should approve it without proposed modifications - even if the FERC would have reached a different result considering the matter de novo.

Deference must also be real and not simply a bunch of words on paper. Given the complexity of the issues, the FERC can always, if it so chooses, chide the NERC for failing to provide more explanation, consider more alternatives, or provide more technical foundation for its proposals. But for the institutional relationship between the FERC and the NERC to be a healthy one, deference must be real. The FERC must truly respect the NERC and the stakeholder process that it uses to develop reliability standards. Without that, no standard of deference, no matter how sound, will repair the institutional rift that has grown steadily over the last several years.

The article is organized as follows. Section II briefly reviews how we got here, particularly as it relates to the FERC's findings on its authority under section 215(d)(5) and the deference due to the NERC. Section III describes the self-regulatory model generally, including how that model has been implemented by the Securities and Exchange Commission (SEC), Commodity Futures Exchange Commission (CFTC), and the FERC as it relates to the North American Energy Standards Board (NAESB). Section IV provides an overview of the principles for judicial deference to agency action, and why they are relevant here. Section V provides my recommendations.

II. BACKGROUND ON THE CONFLICT OVER STANDARDS DEVELOPMENT

Section 215 grants the Electric Reliability Organization (ERO) authority to develop reliability standards in the first instance. Section 215(c)(2)(D) requires that the ERO do so through a process that provides “notice and opportunity for public comment, due process, openness, and balance of interests.”⁶ Once the ERO has developed a standard, section 215 gives the FERC three options. First, it can “approve” the standard if it finds it “just, reasonable, not unduly discriminatory or preferential, and in the public interest.”⁷ Second, it can “remand” the standard if it “disapproves” it.⁸ Third, it can “order the [ERO] to submit . . . a modification to a reliability standard that addresses a specific matter if the Commission considers such . . . modified reliability standard appropriate to carry out this section.”⁹ Importantly, the statute also commands that, when reviewing a proposed standard (or modification thereto), “[t]he Commission shall give due weight to the technical expertise of the [ERO] with respect to the content of a proposed standard or modification to a reliability standard.”¹⁰

This self-regulatory model is in notable contrast to the FERC’s broader authority to promulgate rules under section 206 of the FPA and section 5 of the Natural Gas Act. For example, in regulating transmission and wholesale markets, FPA section 206 provides the FERC broad authority, when finding an existing rule to be flawed, to “fix . . . by order” the rule “to be thereafter observed.”¹¹

This fundamental difference is not an oversight. When the Energy Policy Act of 2005 was being debated, Senators Daschle and Thomas proposed dueling structures for reliability regulation. Senator Daschle proposed giving the FERC broad authority to set reliability standards, much as it does in regulating electricity and natural gas markets.¹² By contrast, Senator Thomas proposed a self-regulatory model. He gave several reasons for this, including that standards development “is very technical work that will require a very large commitment of resources,” and the Daschle bill “fails to account for the international nature,” of the grid by allowing a U.S. agency to set standards affecting Canada and Mexico.¹³ Senator Thomas’ recommendation was consistent with those of the Department of Energy Task Force on this issue.¹⁴ Congress chose the Thomas

6. 16 U.S.C. § 824o(c)(2)(D).

7. *Id.* § 824o(d)(2).

8. *Id.* § 824o(d)(4).

9. *Id.* § 824o(d)(5).

10. *Id.* § 824o(d)(2).

11. *Id.* § 824e(a).

12. “We give [the] FERC the responsibility [for standards]. [The] FERC [may] defer to [other groups] . . . But when push comes to shove, [the] FERC has the responsibility . . .” 148 CONG. REC. 3218 (2002) (statement from Sen. Jeff Bingaman).

13. *Id.* at 3217-18.

14. DEP’T OF ENERGY, MAINTAINING RELIABILITY IN A COMPETITIVE U.S. ELECTRICITY INDUSTRY: FINAL REPORT OF THE TASK FORCE ON ELECTRIC SYSTEM RELIABILITY 67 (Sept. 29, 1998) (“The FERC would either confirm SRRO mandatory standards or deny them and refer them back to the SRRO with comments requesting revision and resubmittal of the standards.”), available at <http://www.nerc.com/docs/docs/pubs/esrfinal.pdf>.

model and thereby declined to give the FERC broad authority to write a standard on its own.

The FERC first addressed this new regulatory model in Order No. 672. It held that the standards development process must produce “technically sound” standards, but also found the process must be “open and fair,” and “balance the interests of stakeholders.”¹⁵ Similarly, it found that standards “should be developed initially by persons within the electric power industry and community with a high level of technical expertise,”¹⁶ and that a “reliability goal must [at times] be balanced against other vital public interests, such as environmental, social and other goals.”¹⁷ It also held, however, that “[t]he proposed Reliability Standard must not simply reflect a compromise in the ERO’s Reliability Standard development process based on the least effective North American practice - the so-called ‘lowest common denominator’ - if such practice does not adequately protect Bulk-Power System reliability.”¹⁸

The FERC first applied this general framework in Order No. 693.¹⁹ In that rulemaking, the NERC had argued that the FERC should broadly defer to any standard produced through its consensus based American National Standards Institute (ANSI)²⁰ process, but the FERC declined, finding:

The Commission agrees with [the] NERC that an open and transparent process is important in implementing section 215 of the FPA and developing proposed mandatory Reliability Standards. However, in Order No. 672, the Commission rejected the presumption that a proposed Reliability Standard developed through an ANSI-certified process automatically satisfies the statutory standard of review. The Commission reiterates that simply because a proposed Reliability Standard has been developed through an adequate process does not mean that it is adequate as a substantive matter in protecting reliability. We will, therefore, review each Reliability Standard to ensure that the Reliability Standard is just, reasonable, not unduly discriminatory or preferential, and in the public interest, giving due weight to the ERO.²¹

The FERC also addressed its authority to order modifications pursuant to section 215(d)(5), holding:

[T]he Commission agrees that a direction for modification should not be so overly prescriptive as to preclude the consideration of viable alternatives in the ERO’s Reliability Standards development process. However, in identifying a specific matter to be addressed in a modification to a Reliability Standard, it is important that the Commission provide sufficient guidance so that the ERO has an understanding of the Commission’s concerns and an appropriate, but not necessarily exclusive, outcome to address those concerns.

Further, the Commission clarifies that, where the Final Rule identifies a concern and offers a specific approach to address the concern, we will consider an

15. Order No. 672, *Rules Concerning Certification of the Electric Reliability Organization*, 114 F.E.R.C. ¶ 61,104 at P 258 (2006).

16. *Id.* at P 324.

17. *Id.* at P 335.

18. *Id.* at P 329.

19. Order No. 693, *Mandatory Reliability Standards for the Bulk-Power Systems*, 18 C.F.R. § 40.1 (2007).

20. The NERC’s standards are approved pursuant to a process that complies with the American National Standards Institute’s criteria.

21. Order No. 693, *supra* note 19, at P 167.

equivalent alternative approach provided that the ERO demonstrates that the alternative will address the Commission's underlying concern or goal as efficiently and effectively as the Commission's proposal.²²

The Commission ordered hundreds of individual standards changes in Order No. 693, and therefore was aggressive in using its authority under section 215(d)(5). In terms of deference, however, the picture was more nuanced than might first appear. The NERC had openly acknowledged that "significant improvements [to the standards] are essential," and that it was planning "to upgrade and improve the existing NERC standards as needed" over the next several years.²³ The NERC therefore focused primarily on the *process* for implementing changes and declined to submit comments on many of the proposed directives in the FERC's Notice of Proposed Rulemaking, stating:

To be consistent with the Commission's authority to direct the development or modification of standards, but not to set the standards, it is essential that the final rule adopted in this proceeding state the directives to improve the standards in the form of an objective to be achieved or concern or deficiency to be resolved within the standard, and not prescribe a particular requirement, metric, or specific language to be used. For the Commission to prescribe a particular requirement, metric, or specific language to be used would, in effect, constitute setting the standard and would countermand the open standards process that the Commission has approved and that is required by law.²⁴

The Commission generally accepted this view in the final rule, holding that "the Commission agrees that a direction for modification should not be so overly prescriptive as to preclude the consideration of viable alternatives in the ERO's Reliability Standards development process."²⁵

The NERC did, however, raise discrete technical issues in its comments and in some cases, the FERC deferred explicitly to the NERC's views. The vegetation management standard (FAC-003-0) - an important standard because tree contacts had contributed to prior blackouts - was a good example. The Commission Staff Preliminary Assessment expressed concern that the proposed standard was too lax and suggested a different one.²⁶ The NERC objected, describing the large body of technical work underlying the proposed standard and arguing that the Staff's alternative "would be an extreme measure as a vegetation clearance standard for reliability purposes and would carry with it an exorbitant and unnecessary burden."²⁷ The Commission ultimately agreed with the NERC, "giving due weight to the technical expertise of the ERO."²⁸

The FERC also deferred to the NERC's views on several major policy issues. For example, the FERC adopted the NERC's position with respect to (i)

22. *Id.* at PP 185-86.

23. Comments of the NERC on Staff Preliminary Assessment, Docket No. RM06-16-000 at 7-8 (F.E.R.C. issued June 26, 2006).

24. Comments of the NERC on the Notice of Proposed Rulemaking for Mandatory Reliability Standards for the Bulk Power System, Docket No. RM06-16-000 at 24 (F.E.R.C. issued Jan. 3, 2007) [hereinafter *Comments of the NERC 2007*].

25. Order No. 693, *supra* note 19, at P 185.

26. FERC Staff Preliminary Assessment of the NERC's Proposed Mandatory Reliability Standards, Docket No. RM06-16-000 at 56 (F.E.R.C. issued May 11, 2006).

27. *Comments of the NERC 2007*, *supra* note 24, at 32.

28. Notice of Proposed Rulemaking, *Mandatory Reliability Standards for the Bulk Power Systems*, 117 F.E.R.C. STATS & REGS. ¶ 32,608 at P 387, 71 Fed. Reg. 64,770 (2006).

limiting initial application of the reliability standards to the Bulk Electric System, rather than expanding their application to the potentially larger Bulk Power System; (ii) accepting an industry-sponsored compromise with respect to the treatment of small entities; (iii) adopting a six-month transition period for enforcement of the new standards that would limit civil penalties to more serious violations; and (iv) approving as enforceable standards that did not yet have “measures” for them (i.e., failed to specify particular metrics against which compliance would be judged).²⁹

This delicate balance of policy accommodations and standards directives represented the high-water mark for collegiality between the FERC, the NERC, and the industry. Not a single request for rehearing was submitted by the NERC, or any major industry participant of Order No. 693.

Since Order No. 693, the relationship has steadily worsened. The primary tension has been between the Commission’s electric reliability staff and industry drafting teams over how to implement Order No. 693’s directives. The agency’s staff believes the drafting teams have often not construed those directives correctly, whereas the drafting teams often consider the staff’s position heavy handed or inflexible. As the NERC politely put it in its Three-Year Assessment, this has created an “atmosphere for tension” in the drafting process.³⁰ There has also been considerable tension, albeit primarily behind the scenes, in the enforcement of reliability standards. Here too, utilities perceive staff as heavy handed or inflexible on the standards at issue.

This growing tension finally came to a head on March 18, 2010, when the Commission issued its slate of reliability orders. It is hard to overstate the collective impact of these orders on the FERC-NERC relationship. In the words of former Chairman Joseph T. Kelliher, the orders “loudly suggest[ed] [the] FERC does not believe [the] NERC has established itself as a strong organization.”³¹

With respect to the tension in the drafting process, the FERC sided with its staff, noting “a growing concern that the current voting process in the ERO rules of procedure can be used to prevent compliance with Commission directives to address particular reliability matters.”³² The FERC expressed concern that “stakeholders” could vote down proposed standards because “a team of industry volunteers . . . may not agree with the Commission’s directive.”³³ The FERC therefore ordered the NERC to revise its Rules of Procedures to “allow [the NERC] to comply with Commission directives to submit new or modified Reliability Standards.”³⁴

The FERC also took several other actions that were critical of the NERC standards process. For example, it criticized the NERC for delaying action on

29. Order No. 693, *supra* note 19, at PP 50-79.

30. NERC, THREE YEAR ERO PERFORMANCE ASSESSMENT-ATTACHMENT 2 (2009) at 9, *available at* http://www.nerc.com/files/ATTACHMENT-2_Comments_and_Recommendations_07-01-09.pdf.

31. The Honorable Joseph T. Kelliher, Remarks at the Reliability Primer for Lawyers and Energy Professionals Energy Bar Association (Apr. 28, 2010), *available at* <http://utilitysvcs.com/docs/Kelliher%20NERC%20speech.pdf> [hereinafter *Kelliher*].

32. *NERC*, 130 F.E.R.C. ¶ 61,203 at P 2 (2010).

33. *Id.* at P 4.

34. *Id.* at P 5.

modifying two standards (BAL-003 and TPL-002), and set specific deadlines for compliance.³⁵ The FERC also proposed to summarily reverse the NERC in two cases. In the first, the Commission proposed to reject the NERC's interpretation of an important transmission planning standard (TPL-002).³⁶ The case concerned a technical dispute over the level of redundancy necessary for relays in the study of various transmission contingencies. The NERC approved one interpretation, but the FERC rejected that interpretation and proposed "an alternative interpretation" without any mention of deference or due weight to the NERC's technical expertise.

In the second case, the Commission proposed to remand the time error correction standard (BAL-004).³⁷ This action was unusual because in most prior cases where the FERC found flaws in a proposed standard, it accepted the standard and directed future modifications pursuant to section 215(d)(5). In this case, the FERC proposed to remand the standard entirely, and thereby essentially rejected the NERC's proposal - here again, without any discussion of deference or due weight.

III. THE SELF-REGULATORY MODEL GENERALLY

"Self-regulation" has a distinguished history but an ambiguous moniker. The label applies to models as varied as deregulation (i.e., no standards) to professional organizations that police themselves with specific standards (e.g., bar associations) to government oversight and enforcement of standards developed in the first instance by industry. The latter model is reflected in section 215 and has been implemented for decades by other agencies. As described by Professor Michael in his report to the Administrative Conference of the United States, this model can be described as "audited" self-regulation and, in that form, has numerous benefits:

The literature of regulatory reform suggests several advantages of self-regulation. It should yield better rules because the rules are written by those directly involved in the regulated activity and thus have a better knowledge of the activity. The rules should be less rigid because they can be tailored to the industry or group And because the rules would be perceived by the regulated entities as more sensible and flexible, there would be a greater incentive to comply Finally, this type of regulation is more suited to modern laws and recent developments in regulatory theory which advocate replacement in many instances of old 'command-and-control' regulation with new standards based on performance or outputs.³⁸

The SEC administers one of the most visible and longstanding models of self-regulation, overseeing both the stock exchanges and associations of the

35. *Mandatory Reliability Standards for the Bulk Power Systems, Order Setting Deadline for Compliance*, 130 F.E.R.C. ¶ 61,218 (2010); *Mandatory Reliability Standards for the Bulk Power Systems, Order Setting Deadline for Compliance*, 130 F.E.R.C. ¶ 61,200 (2010).

36. *Interpretation of Transmission Planning Reliability Standard*, 130 F.E.R.C. ¶ 61,208 (2010).

37. Notice of Proposed Rulemaking, *Time Error Correction Reliability Standard*, F.E.R.C. STATS. & REGS. ¶ 32,652, 75 Fed. Reg. 15,371 (2010) (to be codified at 18 C.F.R. pt. 40).

38. Douglas C. Michael, *Federal Agency Use of Audited Self-Regulation as a Regulatory Technique*, 47 ADMIN. L. REV. 173, 174 (1995).

securities dealers (NASD). The original rationale for this model, as Seligman describes, was two-fold:

As articulated during the New Deal Chairmanships of Landis and Douglas, the necessity for securities industries' self-regulation subject to SEC supervision stemmed primarily from two bases. First, the impracticality of direct SEC regulation of the several thousand broker-dealers and business corporations subject to its jurisdiction, and second, a preference for business, with its greater practical knowledge of its own affairs, to participate in the development and application of SEC rules and reduce the likelihood of unnecessary disruption or inefficiency.³⁹

Pertinent here, Congress originally gave the SEC only limited authority over self-regulatory organization (SRO) rules, adopting a "program [that] is based upon cooperative regulation, in which the task will largely be performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation."⁴⁰ After forty years of experience, however, the Congress in 1975 "gave the SEC the power to initiate as well as approve SRO rule-making."⁴¹ Section 19(c) of the 1934 Act, as amended, now provides:

The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as 'amend') the rules of a self-regulatory organization (other than a registered clearing agency) as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this chapter.⁴²

The 1975 Amendments thus constituted "a major overhaul . . . [that] shifted the balance of rulemaking power in favor of [the SEC] oversight," and allowed the SEC to play a larger role in SRO operations.⁴³ Yet, despite its expansive oversight authority, the SEC has generally been deferential toward SRO operations. It "has not been overly active" in exercising its section 19(c) power;⁴⁴ the SEC has adopted only four section 19(c) rules.⁴⁵ Additionally, although an SRO may withdraw a proposed rule change and the SEC may reject a proposed rule change for noncompliance with the filing process,⁴⁶ the SEC rarely disapproves of a proposed rule change as inconsistent with the Exchange

39. Joel Seligman, *Cautious Evolution or Perennial Irresolution: Stock Market Self-Regulation During the First Seventy Years of the Securities and Exchange Commission*, 59 BUS. L. 1347 (2004).

40. S. REP. NO. 75-1455, at 3-4 (1938); H.R. REP. NO. 2307, at 4-5 (1938).

41. Roberta S. Karmel, *The Future of Self-Regulatory Organizations*, N.Y. L.J. (2009), available at <http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202431775063>.

42. 15 U.S.C. § 78s(c) (2006). The only conditions on this authority are the relatively common practices of notice and opportunity for comment, publication of the text of the proposed rule change, and a statement explaining the basis for the proposed rule change. *Id.* § 78s(1)-(4).

43. *Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1129-30 (9th Cir. 2005).

44. *Id.*

45. 17 C.F.R. §§ 240.19c-1-.19c-5 (2010) (The SEC proposed Rule 19c-2 but ultimately did not adopt it); Dale A. Oesterle, *Comments on the SEC's Market 2000 Report: On, Among Other Things, Deference to SROs, the Mirage of Price Improvement, the Arrogation of Property Rights in Order Flow, and SEC Incrementalism*, 19 J. CORP. L. 483, 490 n.53 (1994) (citing *Bus. Roundtable v. SEC*, 905 F.2d 406, 409 (D.C. Cir. 1990)).

46. OFFICE OF INSPECTOR GEN., SEC, AUDIT NO. 438, SRO RULE FILING PROCESS 6 (2008), available at <http://www.sec-oig.gov/Reports/AuditsInspections/2008/438final.pdf>.

Act.⁴⁷ For example, in 2006 and 2007, SROs submitted 1,014 and 1,143 proposed rule changes respectively, and the SEC did not disapprove of a single one.⁴⁸

The history of CFTC authority over SROs rulemaking is similar in some respects. The CFTC (and, prior to its formation, the Secretary of the Department of Agriculture), like the SEC, gradually acquired greater authority over the years to review SRO rules. Under the Grain Futures Act of 1922, Congress did not give the Secretary express authority to review or approve commodity exchange rules.⁴⁹ In 1968 the Secretary of Agriculture was given express authority to “disapprove” certain contract market rules, but there was no affirmative requirement that such rules actually be “approved.”⁵⁰ Six years later in 1974, the statute was again amended “to require affirmative approval by the then-new [CFTC] of contract terms and other trading rules before the contract markets could activate them.”⁵¹

This regime was in place until the Commodity Futures Modernization Act of 2000⁵² overhauled the nature of CFTC regulation of contract markets. Under this new regime, an SRO’s rules need not be filed with the CFTC to be effective; rather, they simply must comply with the core principles set forth in the CFMA.⁵³ However, the CFTC nonetheless retains the authority “to alter or supplement the rules of a registered entity insofar as necessary or appropriate by rule or regulation or by order.”⁵⁴ This right to “alter or supplement” an SRO rule can be triggered only

if after making the appropriate request in writing to a registered entity that such registered entity effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such registered entity has not made the changes so required.⁵⁵

In other words, the CFTC was given something the FERC was not - i.e., the ability to change an SRO rule if, after notice to the SRO, the SRO declined to make the change “on its own behalf.”

Finally, there is the example of the FERC’s own pre-EPA use of an SRO model for the development of jurisdictional business practices for the electric and natural gas industries. Like the NERC, the North American Energy Standards Board (and its predecessor Gas Industries Standards Board) uses a formal, consensus-based process to develop business practices. In the first rulemaking to review such practices, Order No. 587, the Commission considered

47. *Id.* at 6; *see also* Richard H. Pildes, *Separation of Powers, Independent Agencies, and Financial Regulation: The Case of the Sarbanes-Oxley Act*, 5 N.Y.U. J. L. & BUS. 485, 524 (2009) (asserting that the SEC has never given SROs *Chevron*-style deference).

48. OFFICE OF INSPECTOR GEN., *supra* note 46, at 6-7. Note, however, that in 2006 and 2007 the SEC rejected 12.5% and 12.1% of SRO proposed rule changes respectively on procedural grounds.

49. PHILLIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, *DERIVATIVES REGULATION* I 496 (3rd ed. 2004).

50. *Id.* at 182.

51. *Id.* at 183.

52. Consolidated Appropriations Act, 2001, Pub. L. No. 106-554, 114 Stat. 2763 (2000) (incorporated by reference).

53. JOHNSON & HAZEN, *supra* note 49, at 495.

54. 7 U.S.C. §12a(7) (1974).

55. *Id.*

business practices for interstate natural gas pipelines that were created to implement Order No. 636. The FERC adopted all forty standards without change, finding that “GISB’s consensus standards are entitled to great weight since the industry possesses specialized expertise and knowledge of the relevant business practices . . . and, in the final analysis, the members of the industry are the ones that have to conduct business under these standards.”⁵⁶

On the issue of consensus, the Commission held that “deferring to the considered judgment of the consensus of the industry is both reasonable and appropriate,”⁵⁷ and in a passage relevant to the current tension over reliability standards, held:

The adoption of standards obviously requires changes and sacrifices by all parties and, the Commission recognizes that the effects may not always be spread equally among everyone in the industry. But the question is not whether an alternative solution may work better for some parties, but, what is best for the entirety of the interstate pipeline grid. *There can be no perfect or correct solution.*⁵⁸

The FERC has continued to exercise great deference when reviewing NAESB business practice standards. For example, this year the FERC issued Order No. 676-F to incorporate without change business practice standards adopted by the NAESB Wholesale Electric Quadrant “to categorize various demand response products and services and to support the measurement and verification of these products and services in wholesale electric energy markets.”⁵⁹ In doing so, the FERC referenced Order No. 587 and stated:

[The] adoption of consensus standards is appropriate because the consensus process helps ensure the reasonableness of the standards by requiring that the standards draw support from a broad spectrum of industry participants representing all segments of the industry. Moreover, since the industry itself has to conduct business under these standards, the Commission’s regulations should reflect those standards that have the widest possible support.⁶⁰

Further, in Order No. 587-T, the FERC recently incorporated by reference 148 of 150 changes⁶¹ made by Version 1.8 of the NAESB Wholesale Gas Quadrant’s (WGQ) consensus standards to WGQ’s Version 1.7 consensus standards.⁶²

56. Order No. 587, *Standards for Business Practices of Interstate Natural Gas Pipelines*, [Regs. Preambles 1991-1996] F.E.R.C. STATS & REGS. ¶ 31,083, 61 Fed. Reg. 39,053 (1996) (to be codified at 18 C.F.R. pts. 161, 250, & 284).

57. *Standards for Business Practices of Interstate Natural Gas Pipelines*, 61 Fed. Reg. 39053, 39057 (1996) (to be codified at 18 C.F.R. pts. 161, 250, & 284).

58. *Id.* at 39,061 (emphasis added).

59. Order No. 676-F, *Standards for Business Practices and Communication Protocols for Public Utilities*, F.E.R.C. STATS & REGS. ¶ 31,309, 75 Fed. Reg. 20,901 (2010) (to be codified at 18 C.F.R. pt. 38).

60. Final Rulemaking, *Standards for Business Practices and Communication Protocols for Public Utilities*, 75 Fed. Reg. 20,901, 20,903 (2010) (to be codified at 18 C.F.R. pt. 38).

61. The FERC did not incorporate two changes because they conflicted with the FERC’s previously adopted record retention requirement in 18 C.F.R. § 284.12(b)(3)(v). Final Rulemaking, *Standards for Business Practices for Interstate Natural Gas Pipelines*, 74 Fed. Reg. 9,162, 9,163 (2009) (codified at 18 C.F.R. pt. 284).

62. *Id.* at 9,162, 9,163; *see also, e.g.*, Final Rulemaking, *Standards for Business Practices of Interstate Natural Gas Pipelines*, 70 Fed. Reg. 28,204, 28,206 (2005) (to be codified at 18 C.F.R. pt. 284) (incorporating by reference the NAESB WGQ’s Version 1.7 consensus standards) (“[S]ince the industry itself has to conduct business under these standards, the Commission’s regulations should reflect those standards that have the widest possible support.”); Final Rulemaking, *Standards for Business Practices of Interstate Natural Gas*

In addition to the NAESB SRO model, it is worth noting that the Commission routinely encourages Regional Transmission Organizations (RTOs) to develop consensus-based solutions. Indeed, on some of the most vexing issues facing RTOs - such as transmission cost allocation and capacity market design - the Commission has specifically urged RTO stakeholders to reach consensus, rather than proposing its own approach.⁶³ This is the case even though the Commission has broad power to propose rule changes under section 206.

IV. JUDICIAL DEFERENCE TO AGENCY DECISIONS

The literature and precedent concerning judicial deference to agency decision-making is also helpful in considering how much deference should be given to the NERC. The policy rationales applied in this context - which range from the technical to the political to the process oriented - are briefly described below.

The original vision of the New Deal administrative agency was that of an expert solving complex problems in a non-political atmosphere. This, in turn, supported the rationale that courts should defer to federal agencies for technical reasons, as Herz explains:

[T]he New Deal reformers generally . . . rested their hopes for administrative government on three basic principles: the affirmation of expertise, agency insulation from central political control, and agency insulation from political oversight. The three very much went together; because the problems faced by agencies are technical ones to which there are right and wrong answers, administrators must be expert, and they should be left alone to do their work.⁶⁴

Seidenfeld's appraisal is similar, underscoring the search for the "right" answer to highly technical questions:

[T]he [agency expertise] model posits that agency decisions are not political because if everyone had the same knowledge and experience as the agency, all would agree that the agency's solution was best for the public interest. In other words, although agencies may set regulatory policy, they do not make

Pipelines, 65 Fed. Reg. 77,285, 77,286 (2000) (to be codified at 18 C.F.R. pt. 284) (incorporating by reference "the most recent version of consensus [industry] standards promulgated by the [GISB].") ("[A]doption of consensus standards is appropriate because the consensus process helps ensure the reasonableness of the standards by requiring that the standards draw support from a broad spectrum of all segments of the industry."); Final Rulemaking, Standards for Business Practices of Interstate Natural Gas Pipelines, 64 Fed. Reg. 17,276, 17,277 (1999) (codified at 18 C.F.R. pt. 284) (adopting the GISB's most recent business practices and communication methodologies standards) ("[A]doption of consensus standards is appropriate because the consensus process helps ensure the reasonableness of the standards by requiring that the standards draw support from a broad spectrum of all segments of the industry."); Final Rulemaking, Standards for Business Practices of Interstate Natural Gas Pipelines, 62 Fed. Reg. 5,521, 5,522 (1997) (codified at 18 C.F.R. pt. 284) (incorporating by reference without change GISB's internet server standards for conducting business transactions) ("The Commission is adopting the consensus view of the industry that the Internet server model is needed to provide customers with a framework for conducting these business transactions efficiently.").

63. See, e.g., *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, 131 F.E.R.C. ¶ 61,253 (2010).

64. Michael Herz, *Some Thoughts on Judicial Review and Collaborative Governance*, 2009 J. DISP. RESOL. 361, 363 (2009).

controversial, value-laden choices, but rather use their expertise to solve technical problems left to them by Congress.⁶⁵

This notion of the expert agency toiling in a nonpolitical world has, not surprisingly, given way to a more modern assessment of the administrative state grounded in theories of Congressional delegation and political accountability:

Starting in the second half of the twentieth century, however, the general trend has been away from the idea that there is a science of administration. Agencies are more often perceived instead as addressing questions that do not have right answers; as a result, what legitimates agency decisions is a democratic pedigree. On this view, expertise is less relevant and political influence less problematic. Indeed, political influence becomes necessary to give agency decisions legitimacy, for nothing else can do so.⁶⁶

This shift is perhaps best illustrated by the famous *Chevron*⁶⁷ decision itself. The Supreme Court, in *Chevron*, considered a change in policy by the Environmental Protection Agency (EPA) that was prompted by a change in Administration - i.e., one prompted by policy considerations, not technical ones. The Court, in setting the boundaries for a modern theory of deference, held as follows:

[A]n agency to which Congress has delegated policymaking responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments [I]t is entirely appropriate for this political branch of the Government to make such policy choices⁶⁸

Although the Court did not abandon technical considerations entirely as a rationale, it recognized that they cannot be considered in a vacuum:

In these cases the Administrator's interpretation represents a reasonable accommodation of *manifestly competing interests* and is entitled to deference: the regulatory scheme is *technical and complex*, the agency considered the matter in a detailed and reasoned fashion, and the decision involves *reconciling conflicting policies*.⁶⁹

Making the point even more explicitly, the Court held:

While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make such policy choices—resolving the *competing interests* which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.⁷⁰

Perhaps the closet strand of literature on the issue of deference to consensus-based processes is that on “regulatory negotiation.” Regulatory negotiation (or reg-neg) is an open, consensus based approach to formulating agency rules popularized initially in the environmental area to reduce litigation

65. Mark Seidenfeld, *A Syncopated Chevron: Emphasizing Reasoned Decisionmaking in Reviewing Agency Interpretations of Statutes*, 73 TEX. L. REV. 83, 90-91 (1994); see also Herz, *supra* note 64, at 363 (theory is that “the problems faced by agencies are technical ones to which there are right and wrong answers, administrators must be expert, and they should be left alone to do their work”).

66. Herz, *supra* note 64, at 363.

67. *Chevron v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

68. *Id.* at 865-66.

69. *Id.* (emphasis added).

70. *Chevron*, 467 U.S. at 865-66 (emphasis added).

over new regulations. Commenting on the competing rationales for deference as applied to this model, Herz explains that:

[T]he stronger claim for collaborative governance [reg-neg] sounds not in expertise but in democracy [I]f the collaborative process is truly inclusive, leading to a consensus among representatives of all stakeholders, then it can claim a democratic legitimacy that ordinary agency decision-making lacks (and some agency decision-making, reflecting the asymmetries in access and information of different interests, lacks profoundly). What makes the outcome worthy of respect, then, is that it reflects consensus among all stakeholders. It is this consensus that bestows reg-neg its ‘legitimacy benefit’ among the participants and its claim to the respect of nonparticipants.⁷¹

V. RECOMMENDATIONS

Drawing on the foregoing literature and precedents, I offer the following recommendations regarding (i) the FERC’s authority to order modifications to a reliability standard; and (ii) the deference that is due to the NERC’s proposed standards.

A. *The FERC’s Authority to Order Standards Modifications*

Section 215(d)(5) provides the FERC with authority to require the NERC to “submit . . . a proposed reliability standard” that addresses a “specific matter.”⁷² As a threshold matter, it seems fairly clear that this does not give the FERC power to rewrite a standard or dictate its precise terms. There would have been little reason to restrict the FERC’s authority in section 215(d)(4) to “remand” a standard that it “disapproves in whole or in part” if it had intended to give the FERC the power to rewrite such a standard under section 215(d)(5).⁷³ If Congress had wanted to give the FERC that power, it also could have used readily adaptable language in the Securities and Exchange Act or Commodity Futures Modernization Act, but chose not to.

But beyond this threshold question it gets a bit messy. The FERC was correct in Order No. 693 in holding that section 215(d)(5) does not give it authority to dictate an “exclusive” outcome and that the NERC should have discretion to propose an “equivalent approach.”⁷⁴ This construct can break down, however, in at least two circumstances. The first is where the FERC does not consider the NERC’s response to be “equivalent” and therefore keeps remanding until it is satisfied.⁷⁵ This Mexican standoff should be rare if, as I describe below, appropriate deference is given to the NERC. But it can happen. This does not make the process wrong; it is just the one Congress adopted after striking a balance between the need for agency oversight and the benefits of self-regulation.

Second, the process can break down if the NERC does not submit *any* response. This can happen, for example, if the NERC (or the ballot body) believes the FERC is seeking to address a non-reliability objective through its

71. Herz, *supra* note 64, at 365.

72. Federal Power Act, 16 U.S.C. § 284o (2005).

73. *Id.*

74. Order No. 693, *supra* note 19, at P 186.

75. *Id.*

section 215 authority (which was the situation with FAC-008), and therefore declines to approve any change.⁷⁶ It can also happen if the FERC's directive seems at first blush reasonable, but, after closer examination during the standards development process, it is deemed unwise and therefore voted down.

The question in these latter situations is whether the NERC should be forced to propose a standard to which it objects. The FERC's recent order on rehearing of its March 18 order regarding section 215(d)(5) is ambiguous on this point. It holds that "discretion exists in *how* the ERO chooses to affirmatively respond, not in *whether* the ERO will affirmatively respond."⁷⁷ Continuing, the Commission held that, although the NERC can "exercise its technical expertise to develop new and modified Reliability Standards through an open and collaborative stakeholder process . . . [it must] submit some affirmative response to the Commission's directive."⁷⁸

The NERC has drafted a modification to its Rules of Procedure that may satisfy this holding because it ensures that, if stakeholders vote down a revised standard, "NERC shall, within thirty days of the failed re-ballot, file a report with the applicable ERO governmental authority regarding the circumstances of the matter."⁷⁹ Although this proposed rule change does not give the NERC authority to *draft* a standard on its own, it does, as the FERC's rehearing order requires, provide some affirmative response to the Commission's directive.

It remains to be seen how the FERC will view this proposal. The FERC may continue to balk at the possibility that one of its directives could be voted down by the registered ballot body. But the alternative is not particularly appealing. The NERC is independent and has every right to disagree with the FERC. If that disagreement is clear at the outset, the NERC could appeal the original directive.⁸⁰ But some disagreements may become apparent only after considering whether there are truly sound solutions that address the FERC's concern. If the NERC determines there are none after completion of its stakeholder process, a broad reading of the FERC authority would leave the NERC no choice but to propose a standard with which it disagrees. This would create several problems, including the need for a new process to provide

76. One might ask why the FERC would ever do this - address market issues via section 215 - because its authority to promulgate market rules under section 206 is so much broader than it is under section 215. The reason is that the breadth of the *entities* covered by section 215 is far greater than that covered by section 206 - most notably the large transmission systems owned by public power entities (particularly in the West) that are not "public utilities" subject to section 206.

77. *NERC*, *supra* note 5, at P 32.

78. *Id.*

79. Press Release, NERC, Request for Comments on Proposed Amendments to NERC's Rules of Procedure at ¶ 4.4, available at http://www.nerc.com/files/Notice_CommentPeriodProposedAmendments_NERC_ROP-Section300.pdf.

80. The Commission often seeks to have appeals dismissed if there are continuing proceedings that might narrow or alter the nature of the underlying dispute. The FERC's order on rehearing appears to signal that it would not take such an action (e.g., arguing that judicial review does not lie until the NERC has completed its review of the directive to determine whether an "equivalent alternative" is available) if the NERC appealed a FERC directive under section 215(d)(5). *NERC*, 132 F.E.R.C. ¶ 61,218 at P 5 ("NERC and industry stakeholders can . . . comment on Commission proposals to direct new or modified Standards pursuant to section 215(d)(5); request rehearing of Commission directives they judge to be misguided, overly prescriptive, technically unsound, or *ultra vires*; [and] seek judicial review if the Commission confirms the directives . . .").

stakeholders the opportunity to comment on the NERC's proposal before it is submitted to the FERC and, in addition, an undesirable situation where the NERC's Board is forced to vote for a "proposal" that it is really not proposing. It is, in part, for these reasons that former Chairman Kelliher has argued that the NERC should not be required to submit a proposed standard to which it objects.⁸¹

It is not clear how a court will ultimately resolve this tension, but it is clear to me that the greatest danger is splitting legal hairs, and thereby losing sight of the bigger picture. Isolated disputes between the FERC and the industries it regulates are inevitable. The judiciary provides a backstop to resolve them. That is the way our government works and occasional conflicts rarely risk longer term harm to our institutions. But recurring, systemic conflicts between institutions (the FERC and the NERC) of the kind witnessed recently in the reliability area cannot be resolved by the judiciary in any meaningful fashion and can seriously undermine both the FERC's credibility and the NERC's independence.

Something must change. In my view, the change most likely to heal the current rift is for the FERC to begin to use its section 215(d)(5) authority primarily to guide overall policy direction on matters of fundamental national importance. The FERC is the entity charged with overseeing the entire reliability program, and focusing its efforts on these broad policy areas is the best use of the FERC's scarce resources and political capital. Although the FERC ordered hundreds of specific changes in Order No. 693, it did so in the context of standards that the NERC itself had conceded needed strengthening. This approach cannot continue indefinitely, however, without severely undermining the FERC's credibility, the NERC's independence and the vitality of the standards development process.

This does not mean the FERC should play a weak role. The FERC currently plays a mixed role - reactive but aggressive - by waiting to review whatever standards are submitted and then ordering multiple changes to them. This approach is, in many respects, an unfortunate legacy of the hundreds of changes required by Order No. 693. Although the FERC cannot rubber stamp the NERC's compliance with these requirements, it also should not lose the forest for the trees by focusing primarily on these legacy items.

The FERC's recent decision to hold periodic technical conferences on important reliability issues is a strong step in the right direction.⁸² These conferences could, as suggested by the NERC, "be used to better understand the scope and meaning of reliability (e.g., cascading versus load loss), tradeoffs between reliability and cost to customers, strategic objectives with regard to critical infrastructure security, reliability impacts of new technologies, and priorities for addressing risks to reliability."⁸³ By focusing on these high level issues, the Commissioners should gain a broader perspective of the standards development projects that merit the highest priority and a deeper understanding of the competing objectives that must be balanced in writing standards to address

81. *Kelliher, supra* note 31, at 5 ("If the ERO does not believe a particular standard [meets the statutory test], it should not file that standard with [the] FERC - in fact it has a duty to withhold filing.")

82. *NERC*, 132 F.E.R.C. ¶ 61,217 at PP 12-13 (2010).

83. *Id.* at P 11.

them. This, in turn, may encourage greater deference to how those competing objectives are handled by the NERC, an issue to which I now turn.

B. *The Standard for Deference*

This second issue is that of deference. I recommend that the FERC provided greater guidance on the “due weight” standard and, in doing so, make clear that so long as the NERC has provided a rational explanation for a standard, the FERC will defer to the NERC - even if the FERC would have reached a different result considering the matter *de novo*. This approach is consistent with the rationality test articulated in *Motor Vehicles Manufacturers Ass’n v. State Farm Automobile Insurance Co.*⁸⁴ The *State Farm* test draws a line between agency action that is “reasonable” and that which is “arbitrary and capricious.”⁸⁵ In the passage most relevant here, the Court explained:

Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: “[w]e may not supply a reasoned basis for the agency’s action that the agency itself has not given” We will, however, “uphold a decision of less than ideal clarity if the agency’s path may reasonably be discerned.”⁸⁶

Applying *State Farm* to the FERC’s review of the NERC standards would require two changes to the status quo - one from the FERC, and one from the NERC. First, the FERC must transition to a posture where it no longer substitutes its judgment for the NERC if the NERC has provided a rational explanation for its decision. There is no single right answer to every reliability question, and the NERC’s standards development process should be entitled to deference in balancing competing objectives so long as a rationale explanation is provided.

Second, on the NERC’s part, it must better *explain* the choices made in the ANSI process. The FERC cannot be expected to defer in a vacuum. As I have written previously, the existing standards development process is not perfectly suited to articulating the choices made in a manner helpful to the FERC:

Although extraordinary technical expertise is used to draft standards, that expertise is often diluted in the record submitted to the FERC. There is typically no “technical report” to support the standards; rather the record mirrors the iterative nature of the process - i.e., the drafting committee proposes a standard, the stakeholders submit comments on it, the drafting committee responds to each comment, the standard is then redrafted, comments are taken and so on. This creates a large “record” - sometimes consisting of 500 pages or more - but not one particularly well suited to produce “deference.” It is more like a “legislative history” - e.g., a collection of floor colloquies.⁸⁷

84. *Motor Vehicle Mfrs. Ass’n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983).

85. RICHARD J. PIERCE, JR., I ADMINISTRATIVE LAW TREATISE 219 (“It seems apparent that step two of *Chevron* is *State Farm*. The Court has never explicitly so held, but it has applied *Chevron* two in that manner in many cases.”).

86. *Motor Vehicle Mfrs. Ass’n of U.S.*, 463 U.S. at 43 (internal quotations omitted).

87. John S. Moot, *Tensions in the Structure for Reliability Regulation*, *Electric Reliability Report* at 2, Mar. 12, 2009, available at http://www.hks.harvard.edu/hepg/Papers/2009/John_Moot_March09.pdf.

I am not suggesting that the NERC or its drafting team must do what the FERC does in contested cases - i.e., prepare a lengthy decision that closely analyzes every issue and explains the rationale for its resolution in detail. This solution would require scores of additional NERC staff and transform it into a "mini-FERC." As Professor Pierce has explained, setting the bar this high is a problem even for many federal agencies.⁸⁸ Rather, I would suggest a more modest solution, namely that the NERC, or the drafting teams, prepare a short and concise summary of the issues and alternatives discussed during the drafting process and submit that summary to the FERC along with the proposed standard. It would also help if, on important matters, a technical report was prepared to explain the basis for the drafting team's original proposal. This already occurs in many instances, and recent improvements to the NERC's standards development process would support continuing movement in this direction.

The FERC recently declined to provide greater guidance on the "due weight" standard, acknowledging that it "has not provided much guidance on what it means to give 'due weight' to the ERO," but "emphasiz[ing] that the ERO must provide an adequate explanation regarding the reliability benefits and technical considerations behind a proposed Reliability Standard or modification to a Standard."⁸⁹ The FERC also stated that, "[i]n the absence of such an explanation, there will be nothing in the record for the Commission to give due weight to."⁹⁰

These statements are fine as far as they go, but I do not believe they go far enough in two respects. First, given the enormous industry resources being devoted to the standards development process - including responding to hundred of pending FERC directives - there are significant benefits to the FERC giving greater guidance on the "due weight" standard. Greater guidance would avoid wasting scarce resources on standards that are later remanded because the drafting teams (or the NERC) did not know what was expected of them. Second, the FERC was correct to hold that the NERC must supply an "adequate explanation" for its proposals, but it should go one step further and find that if a rational explanation is provided, the FERC will not second guess the NERC *even if* the FERC or its staff would have reached a different result on its own.

I recognize that the FERC might consider my recommendation "too deferential" because the FERC, unlike a court, has its own expertise and statutory authority in the area of reliability regulation. I accept that reasonable minds can differ on this point, but, recalling the discussion in section IV, all the traditional bases for judicial deference apply with equal force to the FERC-NERC debate. I note each only briefly here.

First, although the FERC now has significant expertise in the reliability area, it would be hard to argue that the NERC, and the industry, taken as a whole, do not have greater expertise than the FERC. Second, Congress

88. Pierce, *supra* note 85, at 600 ("The open-ended requirement of reasoned decisionmaking an agency must fulfill . . . to avoid the risk of judicial reversal of an agency rule is having a series of adverse effects on agency conduct. It increases significantly the scarce staff resources an agency must devote to a single rulemaking and increases the time required to act by rulemaking; some agencies have concluded that they cannot issue a major rule in less than a decade.").

89. NERC, 132 F.E.R.C. ¶ 61,218 at P 53 (2010).

90. *Id.*

delegated the drafting of reliability standards to the NERC in the first instance, not to the FERC. It is true that the FERC has authority to direct modifications (which is more authority than a court has), but the point is that, on a relative basis, the NERC has more authority than the FERC to craft standards in the first instance. Third, the NERC has a more open and democratic process for drafting standards. Although the FERC's rulemaking procedure is an open one, the ANSI process provides more opportunities for participation, revision, formal voting, and the like than the FERC's processes.

Fourth, there is the issue of political accountability, which is more of a split decision than the first three. The FERC is politically accountable because its members are appointed by the President, and it is subject to close oversight by Congress. But the NERC is accountable in a more direct sense because its standards are *voted on* by the very entities that must live with them. This grass roots accountability includes not just electric utilities, but state governments, end use customers, and regional reliability organizations, each of which has a vote in the ANSI process. I would therefore give the edge here to the NERC, but, even if the FERC is given the edge, it is not enough, in my opinion, to outweigh the first three factors or otherwise undermine the reasons for adapting the *State Farm* test to the question of deference to the NERC.

Two final issues merit discussion. First, it is sometimes said that the FERC's deference should turn on whether it considers the NERC a "strong" organization. I do not consider this a helpful construct from either a practical or theoretical perspective. The NERC sits atop a complex (and talented) self-regulatory model, and the issue is whether deference is appropriate to the decisions reached by the self-regulatory structure, not by the NERC standing alone. Consider the analogy to judicial deference. Should the D.C. Circuit first ask whether the FERC is "strong" before deciding whether to defer? I think not. The issue is one of apportioning institutional responsibilities in a rational manner irrespective of whether one side considers the other strong or weak. The relative strength of the NERC as an organization was undeniably a factor the Commission considered in the early years of implementing section 215, but it is not one that has any particular relevance to the question of deference over the long run. In fact, the failure to provide deference tends to weaken, not strengthen, the NERC.

Second, there is the relationship between the international nature of the electric grid and deference to the NERC. As Senator Thomas explained in supporting the NERC's central role in standard setting, "I fear Canada and Mexico simply will not allow their systems to be regulated directly or indirectly by [the] FERC. After all, of course, they are sovereign nations."⁹¹ I am not suggesting the international nature of the grid means the FERC should assume a weak role. Rather, the point is a narrow one: Canada and Mexico are far less likely to object to the approach advocated here - the FERC setting overall policy direction and priorities - than an approach where the FERC seeks to micromanage how those policies and priorities are accomplished.

91. 148 CONG. REC. S1874 (Mar. 14, 2002) (statement from Sen. Craig Thomas).

VI. CONCLUSION

The growing pains experienced by the reliability self-regulatory program are not surprising because the program is so young, but they are more severe than they need to be. The lack of communication between the NERC and the FERC is part of the problem, but the problem is more fundamental. It is, in my view, a problem of policy focus and deference. Without a change in both areas, the FERC will continue to order hundreds of standards modifications, with the resulting workload stressing the system and causing delays that only further increase the FERC's frustration and, in turn, increase the likelihood of a judicial clash over the scope of the FERC's authority under section 215(d)(5) - a clash that is not, in my opinion, the root cause of the problem, but rather just a symptom of it. It is a problem that should, in my view, be resolved by the FERC reorienting its role to focus on broad policy objectives in its section 215(d)(5) orders and providing real deference to the NERC when reviewing individual standards.