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FERC Proposes to Revamp the Standards of Conduct

On March 21, 2008, the Federal Energy Regulatory Commission (the Commission, or FERC) issued a new Notice of Proposed Rulemaking (NOPR) that proposes to recast significantly the Standards of Conduct applicable to FERC-jurisdictional providers of electric transmission and natural gas transportation service (Transmission Providers). Comments on the new NOPR are due by May 12, 2008.

The Commission has replaced altogether the proposal it issued in the same docket more than a year ago. That earlier proposal would have made only incremental changes to the currently-applicable Standards of Conduct. The Commission took the unusual step of issuing an entirely new NOPR because it concluded, after reviewing extensive comments from industry participants, that "the existing Standards are too complex to facilitate compliance or support our enforcement efforts." Highlights of the new NOPR are as follows:

Use of a Functional, Rather Than a Corporate, Approach to Independent Operation

The Commission proposes to abandon the currently applicable "corporate separation" approach to independent operation—under which *all* employees of an Energy or Marketing Affiliate must operate independently of the Transmission Provider's transmission employees. Instead, the new NOPR would identify the employees that need to be separated based on their specific functions within the company. Under this approach, only "transmission function employees"—defined as any person who is "actively and personally engaged" in the conduct of transmission operations, or the planning, directing, organizing, or carrying out of transmission system operations—must operate separately from "marketing function employees." These are defined as people who are "actively and personally engaged" in buying and selling energy, capacity, and demand response service at wholesale.

Elimination of "Shared Officers and Employee" Designations

The NOPR identifies the existing corporate separation approach as one of the primary factors complicating the administration of the rule, and the elimination of that approach also permits FERC to eliminate categories of "shared officers and employees"—that is, those employees that are permitted to operate within both the transmission function and within a Marketing or Energy Affiliate. Under the proposed approach, the universe of "transmission function employees" and "merchant function employees" would be smaller, and—in FERC's assessment—there would be no need for the sharing of employees between these two groups.

While the NOPR eliminates the shared officer and employee designations, it declines to adopt a bright line threshold based on job title for determining whether supervisory level employees, officers or directors are subject to the Standards of Conduct rules as transmission or marketing function employees. For example, the NOPR states that if an officer or other supervisory level employee is charged with the general responsibility of overseeing system control center personnel or marketing functions, but does not engage in system operations or grant or deny transmission service requests, then that person will not be deemed to be a transmission function employee and will not be subject to the independent functioning requirement. However, if an officer or other supervisory level employee engages in such operational activities or engages in decision-making regarding such activities, the NOPR states that that person will be subject to the independent functioning requirement. The same rationale applies to officers and other supervisory level employees engaged in market functions.

Expansion of the No-Conduit Rule

At the same time that the Commission proposes to shrink the universe of employees characterized as being part of the "transmission function" or the "merchant function" for Standards of Conduct purposes, it proposes to expand the application of its "no-conduit rule" to all employees of a Transmission Provider. Under the proposed rule, all employees, even those not designated as either a "transmission function employee" or a "merchant function employee," would be strictly forbidden from conveying non-public transmission information to a merchant function employee.

Permitted Interactions, and the Transparency Rule

The Commission also proposes to permit transmission function and merchant function employees to interact and share information necessary to perform generation dispatch, and to maintain reliability or restore operation of the transmission system. However, the Transmission Provider is required to make a contemporaneous record of the exchange (except in emergency circumstances, in which case the record may be made after-the-fact), and must retain (but need not post) such records for at least five years.

Implications of the NOPR

For public utilities and natural gas pipelines, the key aspect of the new NOPR is that it is designed to make the Standards of Conduct more enforceable. It is clear from the conclusions set forth in the NOPR that FERC believes that it faces significant challenges in enforcing the existing Standards of Conduct, and the rules proposed in the new NOPR are intended to facilitate FERC's enforcement efforts. If the proposed rules are adopted, the Commission's efforts to enforce the Standards of Conduct may become even more active, and it is likely that the Commission will be assertive in attempting to impose civil penalties on entities violating the Standards of Conduct.

In this regard, the NOPR places particular emphasis on the role of the Chief Compliance Officer (CCO) in ensuring compliance with the Standards of Conduct. The NOPR pointedly affirms that the CCO is responsible for: (1) fielding questions from employees regarding the nature of transmission function information or persons to whom it may be passed; (2) preventing prohibited exchanges of information; and (3) curing any prohibited exchanges by the posting of the information. It is clear that the Commission views an effective and active CCO as the lynchpin of a company's compliance efforts, and its enforcement efforts will focus on the role played by a company's CCO in ensuring Standards of Conduct compliance.

Further, although the proposed rule would modify the Standards of Conduct in ways that have been sought by the electric and natural gas industries, it would still require the expenditure of significant effort and resources by regulated entities in order to ensure compliance. Transmission Providers would still have to go through the exercise of identifying transmission function and merchant function employees, ensuring that they operate independently, ensuring that their interactions conform to the mandates of the rule, and training all employees affected by the rule. Under the proposed Standards of Conduct regulations, existing internal controls and measures implemented by Transmission Providers (*e.g.*, password protection and other measures used to restrict access to shared computer systems, databases or software containing non-public transmission information) would remain relevant and necessary.

Finally, until the Commission issues a final rule on the proposals set forth in the NOPR, the existing Standards of Conduct are still in effect. A new rule may not be issued for many months. Thus, a Transmission Provider should continue to comply with the existing Standards of Conduct until a new rule becomes effective.