DAVID R. NEVIUS
Vice President

NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL

Princeton Forrestal Village, 116-390 Village Boulevard, Princeton, New Jersey 08540-5731

August 19, 2002

Mr. Charles H. Yeung
Director, Business Standards
Asset Commercialization
Reliant Resources
P.O. Box 286
Houston, Texas 77001-0286

Dear Mr. Yeung:

Response to Comments
ANSI Accreditation Application

We have reviewed your supplemental comments, dated August 8, 2002, on the North American Electric Reliability Council (NERC) application for accreditation as a standards developer by the American National Standards Institute (ANSI). Our responses to your supplemental comments are enclosed.

We hope that our responses to your most recent comments help alleviate your concerns, most of which were cited in your initial comments, and demonstrate to you and others that NERC's new standards development process is an effective consensus process that is fair, open, balanced, and inclusive of all participants.

Sincerely,

DRN
Enclosure

cc: Jim Thompson, ANSI

NERC RESPONSES SHOWN IN BLUE

August 8, 2002

Recording Secretary of the ExSC at ANSI Headquarters
PSA@ansi.org

Subject: Reliant Resources, Inc. Clarifications of North American Electric Reliability Council's "Response to Comments – ANSI Accreditation Application, July 22, 2002"

On July 7, 2002, Reliant Resources submitted comments regarding NERC's May 17, 2002 "Application for Accreditation as a Standards Developer". In those comments, Reliant raised some concerns about NERC's voting structure and the scope and governance of the NERC organization. In NERC's letter of July 22, 2002 in response to Reliant's comments, NERC makes some responses to Reliant's comments that Reliant wishes to clarify in this letter.

NERC Has Rejected Reliant's Viewpoints Already

It is true Reliant had raised issues in our comments before as NERC states and that the NERC process rejected our viewpoints. However, this is the precise reason why Reliant continues to raise these concerns. In the existing NERC structure to develop their proposed process, Reliant's and others' viewpoints that were similar were rejected. NERC claims that since they employed an open and balanced process to derive the resultant new standards process and voting model, Reliant's position is not the will of consensus and therefore was rightly rejected. NERC's response to Reliant's comments seems to rationalize that Reliant's comments are invalid because we participated in their process and having done so, our comments and concerns raised in their Application for Accreditation should also be rejected. NERC fails to recognize that the parties with interests to maintain the rules of the road as they are today are the same entities that have a controlling vote in the existing NERC process as well as the proposed standards development process employing a 9-segment model for ANSI accreditation. Many of the existing reliability rules provide economic advantages to these parties. Reliant only asks that ANSI fully consider Reliant's concerns about the NERC process even if they have already been addressed under a process that did not have to stand ANSI's principles of openness and balance of interests. Reliant believes that ANSI too will identify similar concerns about the open, and balanced nature of NERC's proposed standards process.

RESPONSE: NERC believes it conducted a fair and open process in determining the nine segments for its weighted-segment voting model. NERC devoted significant time and effort to the consideration of comments on what should be the segments in its weighted-segment voting model. The task force that developed the initial proposal welcomed participation from any member of the NERC Stakeholders Committee, which itself is a broad based group with representation from all industry stakeholders. The task

force also posted the proposed segments for public review and comment, and took all of those comments, including those of Reliant, into consideration in making its final recommendations to the NERC independent Board of Trustees. As cited in the task force's report to the Board,

> *"The bulk of the comments focused on what should be the segments in the weighted-segment model. There was no convergence of views, with some commenters supporting more segments, and some less. Regarding the range of views on what should be the segments, the task force believes that a responsive, flexible process is the best way to assure that the WESM objectives of a fair, open, balanced, and inclusive standards development process are achieved, and that the nine segments and segment guidelines in its proposal are a reasonable starting point for the weighted-segment voting model. The task force does recommend that the NERC Board review regularly the initial experience with these segments and guidelines, and the weighted-segment voting model overall. These reviews should occur at least at each Board meeting; the NERC Board should recommend adjustments, as necessary. Such reviews should include how the segments are populated, voting behavior, and regional and Interconnection balance."*

By far, the strongest evidence NERC can present in support of the fairness of its decision is that it was made by the independent NERC Board. Stakeholders from every part of the industry, each with their own vested interests, lobbied for their preferred segment model and voting procedures. In reaching its decision, the Board took into account the range of views expressed in the public comments as well as the advice it received from NERC's broadly representative Stakeholders Committee. In the end, NERC's independent Board was convinced that the proposed nine-segment model was the most fair and reasonable starting point. In approving the nine-segment model, the NERC Board committed to review, at least at each of its meetings, the effectiveness of this model and to make adjustments as appropriate. NERC strongly believes that having its independent Board make the key decisions, such as determining the segments and other procedures for its standards development process, was a critical step in making the transition from NERC's former standards process to the new voting model and new process.

NERC's Organization Standards Process Already Demonstrates Industry Preference

NERC seems to believe that their process is worthy of ANSI accreditation as demonstrated by the number of industry participants who have registered under their proposed standards approval voting structure. What NERC fails to recognize here is that the 400 persons registered for the ballot body and the 266 who have declared interest in one of the nine industry segments, have no alternative but to participate in the NERC process, as they have in the past, to continue to protect their market and commercial interests as best they can. A lack of a process to ensure that market concerns are addressed fairly makes this necessary. For this reason, Reliant has participated actively in NERC committees and working groups and will continue to participate in the new 9-segment model to try to best protect our interests. One cannot assume by the mere

number of registrants that NERC got the process right just as one cannot assume that the turnout of registrants was because NERC got the process wrong.

RESPONSE: The whole purpose of the process NERC has set up is to ensure that parties participate to ensure that their interests are represented. We do not view this as a flaw in the process; on the contrary, that is what is intended. As such, NERC believes that the number of industry participants who have registered for its Registered Ballot Body is strong evidence of the industry's acceptance of the NERC process and their desire to participate in it. Reliant, however, appears to prefer a standards process over which it could exercise more control.

The breadth of industry participation evidenced by the registration of more than 280 entities in the various segments reflects the diversity of interests and views of the electric industry today. NERC believes it is important that all these interests be able to participate on an equal footing in the standards development process, which the NERC process provides.

Parity of Buyers and Sellers is Not Appropriate for NERC's Mission

NERC cites the ANSI Procedures for the Development and Coordination of American National Standards section 1.2.4 Interest Categories. That section states that consideration shall be given to at least the following: a.) Producer b.) User c.) General interest. NERC's response to Reliant's request that a balanced sector voting model should include parity between buyers and sellers is that such a balance is inappropriate and inadequate for purposes of developing electric reliability rules, preferring instead its nine-segment model. Reliant believes that ANSI's basic recognition of producers and users is exactly the parity we seek in a balanced voting model. In the rules that govern reliability for the wholesale electric power grid, the operators and designers of the transmission network are the key players in implementing those rules to assure reliability. Many generators that produce and sell electricity are not owners and operators of the transmission system. NERC's nine segment voting model includes only one segment for a producer of electricity and one for a marketer. These are the only 2 segments in the NERC voting structure that can represent the producer interests. The other 7 segments are: transmission owner, transmission operators and reliability councils (RTOs, ISOs, RRCs), load-serving entities, transmission-dependent utilities, large end-users, small end-users, and governmental owned entities. Although certain entities that are characterized in the other 7 segments may own generation and sell electricity at wholesale, their vertically integrated nature places that generator business interest secondary to a load consuming or transmission cost recovery interest. Not one of these other 7 segments would be seated by entities that have a primary interest in producing electricity for sale. In fact, nearly every one of the 7 non-producer segments is a buyer (user) of electricity in some way.

RESPONSE: In citing the NERC reference to ANSI procedures, Reliant left out several important aspects of those ANSI procedures. The entire excerpt from NERC's initial response to Reliant's comments, with underlining for emphasis, is repeated below:

The interest categories appropriate to the development of consensus in any given standards activity are a function of the nature of the standards being developed. Interest categories shall be defined and such definitions shall be available upon request. In defining the interest categories appropriate to a standards activity, consideration shall be given to at least the following:
a. producer;
b. user;
c. general interest
Where appropriate, more detailed subdivisions should be considered. Appropriate, representative user views shall be actively sought and fully considered in standards activities. Whenever possible, user participants shall be those with the requisite technical knowledge, but other users may also participate. User participation should come from both individuals and representatives of organized groups. There are several user categories.

NERC's understanding of this portion of the ANSI procedures is that it is not limited to creating only three segments, as suggested by Reliant's comments. Indeed, ANSI's procedures suggest the inclusion of additional categories if that is appropriate for ensuring that all relevant interests have the opportunity to participate in the standards development process. The electric industry is undergoing tremendous change. In this time of transition, the electric industry is far more divided than Reliant's simple three-category model would suggest. NERC believes its nine-segment model is far more appropriate to the development of consensus on the kind of reliability standards it has the responsibility to develop.

The Market Interface Principles Makes Reliant's Concerns About Reliability Rules Intruding into Markets Moot

In comments by Reliant concerning NERC's Scope being exclusionary, NERC responds by citing its Market Interface Principles will be applied to its standards development process to safeguard against putting forth any rules that may hinder market activity. Reliant wishes to explain how each of these Principles will not be able to protect the marketplace from NERC establishing rules that impede on business practices and market designs as NERC so claims.

1. *The planning and operation of bulk electric systems shall recognize that reliability is an essential requirement of a robust North American economy.*

   This is a "motherhood and apple pie type statement" and is merely recognition of NERC's scope. This principle offers no protection to the markets. In fact, there is no mention of the market needs in this Market Interface principle at all. Most would agree to this principle, as does Reliant, since reliability of the bulk electric system is truly essential for the North American economy to function.

2. *An Organization Standard shall not give any market participant an unfair competitive advantage.*

This principle only assures that those entities that are actively participating in the buying and selling of electricity are kept on an equal playing field in regard to reliability rules. It fails to recognize that that operators and owners of the transmission grid and other entities that may not be considered "market participants" can be economically advantaged even without active engagement in the buying and selling of energy. The outcome of any reliability rule provides economic benefit to some and harm to others. A transmission owner who does not participate in the wholesale electric market, may be advantaged economically if market participants are unfairly burdened with ancillary operating costs.

3. *An Organization Standard shall neither mandate nor prohibit any specific market structure.*

   This merely states that NERC will not be in the business of designing market structure. It does not prevent a NERC standard from imposing hardships and harm on any given market structure nor does it restrict NERC's rules from negatively impacting market rules.

4. *An Organization Standard shall not preclude market solutions to achieving compliance with that standard*.

   This principle attempts to allow markets to freely develop a solution to meet a reliability standard. However, it is oftentimes the definition and characterization of the reliability standard itself that causes market harm. A standard, that dictates an artificially high reliability limit or requirement, can severely impact transmission access for the marketplace and drive up the cost of transactions. It is the reliability standard (or limit) itself that must be established with due consideration for viable market solutions. Setting the limits absent consideration to the economic impacts is precisely how reliability standards may impede on the marketplace. As a parallel example, there is no doubt that the public would be better served if automobile safety standards protected passengers in a 100 mph frontal impact. However, realizable standards that weigh in available technology, cost, and manufacturability are all considered when automobile safety standards are established. Reliant believes this approach must also be applied in establishing bulk electric system reliability standards.

5. *An Organization Standard shall not require the public disclosure of commercially sensitive information. All market participants shall have equal opportunity to access commercially non-sensitive information that is required for compliance with reliability standards.*

   This merely recognizes the commercial nature of information NERC may employ in the execution of reliability rules and procedures and is not intended to address how reliability rules will accommodate or not impede on market structures.

RESPONSE: The Market Interface Principles, along with the Reliability Principles, are the basis for development of NERC organization standards. They define the purpose, scope, and nature of organization standards, and provide a constant beacon to guide the development of these standards. The Principles also underscore NERC's commitment to ensure that the organization standards that it develops are written such that they achieve their reliability objective without causing undue restrictions or adverse impacts on competitive electricity markets. As such, they are not part of the standards development process, per se, but serve as a substantive statement of the requirements that must be satisfied in any organization standard that is developed. The Market Interface Principles, along with the Reliability Principles, were developed through an open stakeholder process and were ultimately approved by NERC's Board of Trustees in October 2001.

The concerns that Reliant raises in this section of its comments are, in reality, the kind of substantive comments that it should raise in the context of the development of particular standards. That process will allow Reliant to raise issues regarding the impact of a particular standard on markets, and all industry participants will be able to judge and comment on the substance and merits of its claims.

Reliant has several ways of raising such issues during the development of each standard:

- Reliant can submit written comments on proposed SARs;
- Reliant can submit comments on proposed standards;
- Reliant can participate in meetings of SAR and Standards drafting teams; and
- If Reliant believes that it has been adversely impacted by any NERC Standards-related action, Reliant can file an appeal and have that appeal considered in a fair and open manner.

The Market Interface Principles also demonstrate NERC's recognition that reliability standards are interrelated with business practices. In light of that relationship, it is important that reliability standards and related business practices be developed in a coordinated fashion. To assure that coordination, on August 15, 2002, the Chairman of NERC and the Chairman of NAESB signed a letter of intent that commits both organizations to the coordinated development of related standards. The letter of intent is preliminary and contemplates the development of more detailed coordination procedures between NERC and the wholesale electric quadrant of NAESB once that quadrant is fully formed and has selected its representatives. A copy of the letter of intent is attached to this response.

Reliant does not believe that the NERC Market Interface Principles offer adequate protection to market practices and designs. Reliant has stated publicly and filed at FERC that the development of all standards for the wholesale electric industry must consider both reliability and commercial aspects. Reliant does not intend to strip NERC of any of its authority in the area of reliability as they state in their Response. On the contrary, Reliant fully supports NERC's continuation as an organization to usher the technical requirements and data systems necessary to facilitate reliability. Reliant however, questions whether NERC's standards development process should be ANSI accredited

when it has been developed to focus on addressing reliability needs of the wholesale electric industry, and lacks the adequate balance and appropriate safeguards to meaningfully incorporate the commercial concerns into those standards. If NERC is to obtain an ANSI accredited standards development process, it must organize itself such that the ANSI principles of openness, balance, and fairness are truly satisfied.

RESPONSE: In summary, Reliant's most recent comments are generally a restatement of the comments they filed initially, to which NERC has already responded. Reliant's most recent comments seem to focus on what they see as inadequacies in NERC's Market Interface Principles, which are not part of the process for which NERC seeks ANSI accreditation. Having said that, NERC is always open to constructive suggestions for improvement to its Reliability Principles or Market Interface Principles.

The supplemental comments filed by Reliant, along with the NERC response, will be posted on NERC's web site.

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Letter of Intent
Regarding
Communication and Coordination Protocols
between
North American Energy Standards Board
and
North American Electric Reliability Council

A. Introduction

A need exists to develop standards to enhance energy markets throughout North America. There are both business practice and reliability aspects to such standards, and each has implications for the other. The North American Energy Standards Board ("NAESB") and the North American Electric Reliability Council ("NERC") desire to work together to coordinate the development of business practice standards and electronic communication protocols by NAESB and the development of reliability standards by NERC. It is the intent of both organizations that the business practice and reliability standards be harmonized, that all reasonable efforts be made to eliminate overlap and duplication of effort, and that each organization be able to move forward with its appropriate standards development activity while keeping the other fully informed as to its efforts.

The Wholesale Electric Quadrant of NAESB has recently been formed**.** This letter of intent (LOI) is, therefore, preliminary in nature. It will be supplemented by a more extensive memorandum of understanding (MOU) that describes the details of the coordination process after the Wholesale Electric Quadrant of NAESB is populated and elects its representatives**.** The MOU may address other issues that are deemed relevant by the parties, even though these issues are not contained in this LOI.

B. Principles of Agreement

NERC and the Wholesale Electric Quadrant of NAESB (WEQ) will work together to ensure the coordinated development of business practice standards and electronic communications protocols (by NAESB) and of reliability standards (by NERC) in a manner that is both efficient and beneficial to the industry and the marketplace as a whole. This process may include joint standards development as agreed by the parties, recognizing that standards may have both reliability and business practice elements.

C. Coordination Protocols

Coordination should include the following elements, but may include other elements as agreed by the parties:

1. Each organization will notify the other of its anticipated standards development activity for the coming twelve months.

2. NERC will notify NAESB of each proposal to develop a standard as soon as it receives a standard authorization request.

3. NAESB will notify NERC of each proposal that passes triage and is approved by the NAESB Executive Committee to develop a wholesale electric business practice standard or electronic communications protocol.

4. Each organization will notify the other of the relevant comment periods and opportunities to participate in discussions and drafting groups.

5. NERC may participate in the NAESB WEQ standards development process either as an organization or through individual members.

6. NAESB may participate in the NERC standards development process either as an organization or through individual members.

7. NAESB and NERC may form joint working groups for drafting particular standards or parts of standards and may convene joint industry workshops and forums for discussion of particular items. Moreover, NAESB and NERC may jointly agree concerning the timing and method of development of proposed standards, as to reliability and business practice issues.

D. Conflicts

In the unlikely event that conflicts arise that cannot be resolved between the NAESB WEQ and NERC, the matter may be submitted to the Federal Energy Regulatory Commission for resolution. The parties will endeavor to avoid taking this action and may create a joint dispute resolution process.

NORTH AMERICAN ENERGY STANDARDS BOARD

By: _____
William Boswell, Chairman
August 15, 2002

NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL

By: _____
Richard Drouin, Chairman
August 15, 2002