

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

North American Electric Reliability Corporation
Reliability Standards Development and NERC and
Regional Entity Enforcement

Docket Nos. RR09-7-000
AD10-14-000

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132 FERC ¶ 61,217
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

North American Electric Reliability Corporation
Reliability Standards Development and NERC and
Regional Entity Enforcement

Docket Nos. RR09-7-000
AD10-14-000

ORDER ON
THE ELECTRIC RELIABILITY ORGANIZATION'S THREE-YEAR
PERFORMANCE ASSESSMENT

(Issued September 16, 2010)

1. On July 20, 2009, the North American Electric Reliability Corporation (NERC) filed its “Three-Year Electric Reliability Organization Performance Assessment Report,” (Performance Assessment) in accordance with the requirements of the Commission’s regulations.¹ The Performance Assessment, filed on the three-year anniversary of the Commission’s certification of NERC as the Electric Reliability Organization (ERO) for the continental United States, represents a significant milestone in NERC’s efforts to protect the reliability of the nation’s Bulk-Power System. The Commission continues to believe that a strong ERO is necessary to promote excellence in developing and enforcing mandatory Reliability Standards, as envisioned in Order No. 672.² In this order, we accept the performance assessment of NERC as the ERO, and the Regional Entities, and find that they continue to satisfy the statutory and regulatory criteria for certification. In addition, we direct NERC to submit an informational filing addressing specific matters/concerns and take additional action as discussed in this order.

¹ 18 C.F.R. § 39.3(c) (2010).

² *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204, *order on reh’g*, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006).

2. NERC's Performance Assessment Report highlights the significant progress NERC and the Regional Entities have made in transitioning from a voluntary reliability program to mandatory and enforceable Reliability Standards pursuant to section 215 of the Federal Power Act (FPA).³ NERC has developed 95 Reliability Standards, approved by the Commission, that currently are mandatory and enforceable. NERC has implemented a comprehensive organization registration program, resulting in the registration of over 1,800 entities, including entities in Canada, responsible for compliance with Reliability Standards. NERC also describes the compliance and enforcement program that currently is implemented by NERC and the Regional Entities to ensure ongoing compliance with approved Reliability Standards.

3. Consistent with section 39.3 of our regulations, the Performance Assessment describes how NERC satisfies, on an ongoing basis, the statutory and regulatory criteria for certification as the ERO. In addition, the Performance Assessment assesses the performance for each program area of the ERO, such as Reliability Standards development, compliance and enforcement, and training and operator certification. The Performance Assessment includes Regional Entity and stakeholder feedback. NERC also assesses, on a program-by-program basis, areas where the ERO and the Regional Entities could continue to improve, and identifies over 120 specific action items that will be implemented to address opportunities for improvement.

4. While specific details are discussed below, the Commission believes that, generally, the action items are reasonable and provide practical steps to improve the effectiveness of the ERO and Regional Entity functions and programs. The action items will address important concerns such as accelerating and prioritizing the Reliability Standards development process, enhancing stakeholder communications, improving registration consistency across regions, eliminating the backlog of audit reports and compliance violations, promoting self-reporting of non-compliance, and providing compliance guidance to registered entities. In some instances, the Commission identifies additional action items or refinement of those proposed by the ERO.

5. NERC's filing demonstrates that, generally, NERC has the procedural rules necessary to function as the nation's ERO. In addition, NERC shows that it has the capability to adequately develop and enforce mandatory Reliability Standards. Accordingly, pursuant to section 39.3(c)(2) of the Commission's regulations, the Commission finds that NERC continues to meet the statutory and regulatory criteria necessary for certification as the nation's ERO. Nonetheless, the Commission has

³ 16 U.S.C. § 824o (2006).

specific concerns, explained in more detail below, about the effectiveness of certain NERC programs, most notably with regard to NERC's Reliability Standards development process. As the Commission explained in Order No. 672, the purpose of the ERO performance assessment is to not only determine whether the ERO is satisfying the statutory criteria for certification, but also to identify areas in which the ERO can improve performance.⁴ The Commission further sees the Performance Assessment as an opportunity not only to demonstrate that the ERO has maintained, but also is improving, the quality of its activities and those of the Regional Entities.⁵ Thus, below, we also discuss specific concerns that pertain to the activities of the Regional Entities. Accordingly, the Commission directs NERC to submit an informational filing six months from the date of this order to address the matters discussed in detail below. We also direct NERC to take certain additional actions as discussed in this order. For ease of reference, we have attached as Appendix A a table listing the paragraph numbers containing items to be included in the six month informational filing and the additional actions discussed in this order.

July 6, 2010 Technical Conference

6. In addition to improvements achieved through the Performance Assessment, the Commission held a Technical Conference on July 6, 2010 (July 6 Conference) to discuss industry perspectives on certain issues pertaining to the development and enforcement of mandatory Reliability Standards for the Bulk-Power System. Specifically, the conference focused on the ERO's standards development process and communication and interactions between the Commission, the ERO and Regional Entities. Generally, participants at the July 6 Conference discussed ways to improve communication regarding Reliability Standards, and much of the discussion focused on the possibility of establishing an executive level forum for communication between NERC, the Commissioners and stakeholders.

7. Eighteen entities submitted comments to the July 6 Conference. Almost all post-conference comments address the issue of enhancing communications. Support for an executive forum was split equally among initial commenters. Those that support the creation of a leadership forum seek to ensure frank dialogue among senior level executives, including using the forum to clarify standards development expectations. In contrast, others oppose the creation of an executive forum, citing concerns that it would

⁴ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 186-87.

⁵ *Id.* P 188.

become another layer in the process and might exclude certain stakeholders, such as consumers, from participation. They generally believe that additional communication and coordination between the Commission and NERC could be accomplished through current NERC structures or the Trilateral Oversight Group. In NERC's initial comments, it stated that it supports enhanced communication with the Commission, and committed to discuss these issues at its August 2010 Board of Trustees meeting.

8. After the August NERC Board of Trustees meeting, NERC filed supplemental comments in which it supports executive-level discussions on reliability issues. Instead of creating an executive forum, NERC recommends the Commission convene periodic technical conferences in the format of the July 6 Conference to focus on reliability issues. NERC states that such a reliability summit would provide an opportunity to again bring the five Commissioners, Canadian representatives, executives from various stakeholder groups, and NERC officials together to assess the progress that has been made since the July 6 Conference. NERC suggests the next such conference be held in early 2011 and annually thereafter. NERC also recommends more frequent meetings between its management and senior Commission staff. While NERC states that it has not formally surveyed its stakeholders, based on the discussions at the Board meeting, NERC believes there is widespread support for its proposal.⁶

9. Several post-technical conference comments offer proposals for topics to discuss at a second Commissioner-led conference or reliability summit. Some commenters discuss issues concerning compliance and enforcement. For example, the ISO/RTO council recommends that such a conference explore the concept that compliance audits should be focused on ensuring Responsible Entities meet reliability objectives, rather than looking for violations and assigning penalties. According to the ISO/RTO Council, lessons learned from the audit process should be used to promote assessment of potential gaps and deficiencies in Reliability Standards, and for the development of mitigating measures. ISO/RTO Council also recommends discussing the differences between event analysis and compliance enforcement.

10. Other commenters propose to discuss items related to Reliability Standards development and modification. For example, ITC Holdings proposes that regulators, NERC and industry hold further technical conferences or discussions on how to further simplify the NERC Reliability Standards development process. Duke Energy recommends evaluating how the current approach for identifying and resolving ambiguities in Reliability Standards through NERC's formal interpretation process may

⁶ NERC August 20, 2010 Supplemental Comments, AD10-14-000 at 3.

be improved upon. ISO/RTO Council suggests that one topic to be discussed could be which Reliability Standards are critical to reliability and thus need to be retained or developed, and which standards or requirements are of a supportive or administrative nature and thus could be managed differently. APPA asks that regulators, NERC and industry examine several issues, including the proper balance between reliability and cost to customers, which encompasses the trade-offs between increased investment at the bulk power and local levels. It also proposes that we discuss strategic objectives and design basis threats with regard to protecting the physical and cyber security of our critical electric and other infrastructures. Finally, APPA advises that we look at the impact on reliability of limits on greenhouse gas emissions through legislation or regulation.

11. NERC suggests that the next reliability summit could 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. NERC submits that the ultimate deliverable from such a summit should be a single set of priorities towards which all are working.⁷ NERC recommends that NERC management work with Commission staff to develop the agendas for such conferences.

12. The Commission believes that the July 6 Conference provided a useful, high level discussion of topics that concern NERC, the industry, and regulators in North America and we intend to continue that dialogue. In noticing the July 6 Conference, the Commission stated that it intends to convene a second Commissioner-led technical conference to discuss reliability monitoring, enforcement, and compliance issues.⁸ The Commission will hold a conference on these issues in November 2010. We will work with NERC and international regulators to develop an agenda for this conference. Once an agenda is set, the Commission will issue a notice of this further conference.

13. Going forward, NERC's proposal to hold periodic technical conferences offers a constructive opportunity for NERC, industry, and regulators to discuss policy issues in an open and inclusive forum. NERC and commenters have identified a number of high-level policy issues relating to Reliability Standards development and modification. The Commission believes that a public dialogue on these high-level policy and priority issues

⁷ NERC's August 20 Supplemental Comments at P 3.

⁸ *Reliability Standards Development and NERC and Regional Entity Enforcement*, Supplemental Notice of Technical Conference, Docket No. AD10-14-000 (Jun. 18, 2010).

will help clarify expectations for the NERC Reliability Standards development process. Accordingly, the Commission will also hold a Commissioner-led conference in January or February of 2011, and will work with NERC and international regulators on identifying a date and developing a specific agenda. Once an agenda is set, the Commission will issue a notice of this further conference.

I. Background

A. Section 215 of the Federal Power Act

14. Section 215 of the FPA requires a Commission-certified ERO to develop mandatory and enforceable Reliability Standards, which are subject to Commission review and approval. Once approved, the Reliability Standards may be enforced in the continental United States by the ERO, subject to Commission oversight, or by the Commission independently.

15. Section 215(c) of the FPA establishes the requirements for ERO certification, specifying that the ERO candidate must have the ability to develop and enforce Reliability Standards that provide for an adequate level of reliability of the Bulk-Power System. The statute also requires that the ERO candidate have established Rules that: (1) assure independence, while assuring fair stakeholder representation and balanced decision-making; (2) equitably allocate reasonable dues, fees and other charges; (3) provide fair and impartial procedures for enforcing Reliability Standards through imposition of penalties; (4) provide reasonable notice and opportunity for public comment, due process and balance in developing Reliability Standards and otherwise exercising its duties; and (5) provide appropriate steps to take to gain recognition in Canada and Mexico.

16. Section 215(e)(4) of the FPA provides that the ERO may delegate authority to a Regional Entity for the purpose of proposing regional Reliability Standards and enforcing Reliability Standards. Regional Entities must meet the same statutory criteria as those required for Commission certification of an ERO, except that more flexibility is allowed in the composition of the Regional Entity board of directors. The Commission must approve a delegation agreement between the ERO and a Regional Entity, and the Commission is authorized to “modify such delegation.”

B. Order No. 672

17. On February 3, 2006, the Commission issued Order No. 672 to implement the requirements of section 215 of the FPA. Order No. 672 sets forth the process for certifying a single independent ERO to oversee the reliability of the United States’ portion of the interconnected North American Bulk-Power System, subject to

Commission oversight. Further, in Order No. 672, the Commission mandated a periodic performance assessment “that requires the ERO to affirmatively demonstrate to the Commission that it satisfies the statutory and regulatory criteria for an ERO and is not only maintaining but improving the quality of its activities and those of the Regional Entities to which it has delegated such activities.”⁹

18. To ensure that the ERO complies with the certification criteria on an ongoing basis, the Commission’s regulations at 18 C.F.R. § 39.3(c) set forth the requirement that the ERO file an assessment of its performance three years from the date of initial certification, and every five years thereafter. Specifically, section 39.3(c) requires:

(1) The Electric Reliability Organization’s assessment of its performance shall include:

(i) An explanation of how the Electric Reliability Organization satisfies the requirements of §39.3(b);

(ii) Recommendations by Regional Entities, users, owners, and operators of the Bulk-Power System, and other interested parties for improvement of the Electric Reliability Organization’s operations, activities, oversight and procedures, and the Electric Reliability Organization’s response to such recommendations; and

(iii) The Electric Reliability Organization’s evaluation of the effectiveness of each Regional Entity, recommendations by the Electric Reliability Organization, users, owners, and operators of the Bulk-Power System, and other interested parties for improvement of the Regional Entity’s performance of delegated functions, and the Regional Entity’s response to such evaluation and recommendations.¹⁰

19. In Order No. 672, the Commission stated that the performance assessment should employ regular and systematic measurement and reporting of the ERO’s performance, including information regarding: the ERO’s ability to develop and enforce Reliability Standards providing for an adequate level of reliability of the Bulk-Power System; how the ERO effectively enforced Reliability Standards, including statistical information on its investigations, findings and assessments of penalties, on a regional and continent-wide

⁹ *Id.* P 186.

¹⁰ 18 C.F.R. § 39.3(c)(1) (2010).

basis; and how the ERO provided for fair and impartial procedures for enforcement of Reliability Standards and provided for openness, due process and balance of interests in developing Reliability Standards.¹¹

20. Section 39.3(c)(2) of the Commission's regulations and Order No. 672 explain that the Commission will review the periodic performance assessment and may require follow-up actions by the ERO to comply or improve compliance with the statutory and regulatory qualifications for the ERO, if the Commission determines that the ERO has not satisfied specific criteria.¹² Additionally, section 39.3(c)(2) and Order No. 672 provide that the Commission will assess the performance of each Regional Entity and issue an order addressing Regional Entity compliance.¹³

C. Certification of NERC as the ERO

21. On July 20, 2006, the Commission certified NERC as the ERO for the continental United States under section 215(c) of the FPA.¹⁴ The Commission found that NERC satisfies the criteria to be the ERO responsible for developing and enforcing mandatory Reliability Standards for the United States. Further, the Commission directed NERC to provide additional information and make specific revisions to its Rules in a compliance filing. Through a series of subsequent compliance filings, NERC refined its bylaws, enforcement hearing procedures, penalty matrix and other functions.¹⁵

22. In April 2007, in accordance with section 215(e)(4) of the FPA, and the Commission's regulations at 18 C.F.R. § 39.8, NERC entered into a separate delegation

¹¹ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 189.

¹² 18 C.F.R. § 39.3(c)(2) (2010); *see also* Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 187.

¹³ 18 C.F.R. § 39.3(c)(2) (2010); *see also* Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 33.

¹⁴ *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062 (ERO Certification Order), *order on reh'g & compliance*, 117 FERC ¶ 61,126 (2006), *aff'd sub nom. Alcoa, Inc. v. FERC*, 564 F.3d 1342 (D.C. Cir. 2009).

¹⁵ *E.g.*, *North American Electric Reliability Corp.*, 118 FERC ¶ 61,030 (2007).

agreement with each of the eight Regional Entities¹⁶ by which NERC delegated certain authority to the Regional Entities.¹⁷ Specifically, NERC delegated authority to the Regional Entities to audit, investigate and otherwise ensure that users, owners and operators of the Bulk-Power System comply with NERC's mandatory Reliability Standards, subject to ERO oversight.¹⁸ In addition, the delegation agreements address such matters as: (i) regional Reliability Standards development; (ii) registration of entities that must comply with Reliability Standards; and (iii) other services supporting NERC's statutory reliability functions, including reliability assessments, event analysis and training and education.

II. NERC's Performance Assessment

23. On July 20, 2009, NERC filed its three-year Performance Assessment as required by the Commission's regulations. NERC states that its report shows that NERC is meeting the ERO requirements detailed in 18 C.F.R. § 39.3(b) and that it is successfully carrying out its statutory and regulatory responsibilities. NERC requests that the Commission accept the filing as satisfying NERC's obligation under 18 C.F.R. § 39.3(c) to file a performance assessment on the three-year anniversary of the Commission's certification of NERC as the ERO. NERC indicates that it has made significant strides, on multiple fronts, towards implementing the necessary systems of information, evaluation, standards, enforcement, training, and personnel certification to ensure the reliability of the Bulk-Power System.¹⁹

24. In addition to describing how it continues to meet the ERO certification criteria set forth in the statute and the Commission's regulations, NERC also describes how it has achieved substantial accomplishments toward improving the reliability of the Bulk-Power

¹⁶ The Regional Entities currently are: Florida Reliability Coordinating Council (FRCC); Midwest Reliability Organization (MRO); Northeast Power Coordinating Council, Inc. (NPCC); ReliabilityFirst Corporation (RFC); SERC Reliability Corporation (SERC); Southwest Power Pool, Inc. (SPP); Texas Reliability Entity (TRE); and Western Electricity Coordinating Council (WECC).

¹⁷ See *North American Electric Reliability Corp.*, 119 FERC ¶ 61,060 (2007) (Delegation Agreements Order), *order on reh'g*, 120 FERC ¶ 61,260 (2007).

¹⁸ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 654.

¹⁹ Performance Assessment at 12.

System. For example, NERC identifies that it has developed: (i) a comprehensive body of Reliability Standards; (ii) an organization registration program; (iii) a program for monitoring and enforcing compliance with Reliability Standards; (iv) a program for disseminating alerts on potential reliability issues, independent short- and long-term assessments of reliability and adequacy of the Bulk-Power System; and (v) metrics and benchmarks for measuring reliability performance. NERC also explains that it has established appropriate organizational processes and procedures such as an appropriate and effective governance structure; effective business plans, budgeting, accounting and financial reporting practices; an effective set of Rules of Procedure; and a delegation agreement with each Regional Entity.

25. NERC's filing includes attachments that provide in-depth information on the following matters: discussion of how NERC meets the ERO certification criteria (Attachment 1); stakeholder comments and recommendations to NERC,²⁰ and NERC's discussion of the comments and recommendations and specific NERC actions (Attachment 2); NERC evaluation of the Regional Entities (Attachment 3); joint Regional Entity self-assessment and Regional Entity statements of activities and achievements (Attachment 4); and stakeholder survey results (Attachment 5).

III. Notice and Responsive Pleadings

26. Notice of NERC's filing was published in the *Federal Register*, with interventions and protests due on or before September 3, 2009.²¹

27. Timely motions to intervene were filed by FirstEnergy Service Company, MRO, NPCC, PSEG Companies, RFC, SERC, SPP, TRE and WECC. The American Transmission Company, LLC (ATC) and FRCC filed motions to intervene one day out-of-time.

28. Timely motions to intervene and comments were filed by the American Public Power Association (APPA), the Edison Electric Institute (EEI), the Electric Power Supply Association (EPSA), Exelon Corporation (Exelon) and the National Rural

²⁰ NERC solicited stakeholder comment in the process of developing its Performance Assessment Report. These comments are identified herein as "stakeholder comments" where referenced. Comments submitted in the immediate proceeding are referred to herein as "comments."

²¹ 74 *Fed. Reg.* 38,002 (Jul. 30, 2009).

Electric Cooperative Association (NRECA). On September 18, 2009, NERC filed an answer to the comments.

29. On May 13, 2010, NERC submitted a motion requesting the Commission to issue a preliminary assessment of the Performance Assessment for comment to provide the opportunity for interested parties to weigh in on the preliminary conclusions and recommendations. RFC, MRO, FRCC, TRE, NPCC, WECC, SERC, and SPP jointly submitted comments in support of NERC's motion. EEI, APPA, NRECA, the Transmission Access Policy Study Group (TAPS), EPSA and the Large Public Power Council also jointly submitted comments in support of the motion filed by NERC requesting the Commission to issue a preliminary assessment.

IV. Procedural Matters

30. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.²² We grant the late-filed motions to intervene submitted by ATC and FRCC pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure in view of the early stage of this proceeding, their interests and the interests they represent, and the absence of undue prejudice or delay.²³

31. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure,²⁴ prohibits an answer to an answer or protest unless otherwise ordered by the decisional authority. We are not persuaded to accept NERC's answer and will, therefore, reject it.

32. As discussed further herein, this order largely affirms NERC's existing plans and projects. Thus, the Commission does not believe a preliminary assessment would be beneficial in our ruling on the matters raised in this proceeding. For these reasons, the Commission denies NERC's request for issuance of a preliminary assessment.

²² 18 C.F.R. § 385.214 (2010).

²³ 18 C.F.R. § 385.214(d).

²⁴ 18 C.F.R. § 385.213(a)(2).

V. Discussion

33. The Commission's regulations require the ERO to explain in its three-year performance assessment how it continues to meet the certification criteria described in section 215(c) of the FPA and section 39.3(b) of the Commission's regulations. In addition, the ERO must respond to recommendations by Regional Entities, users, owners, and operators of the Bulk-Power System, and other interested parties for improvement of the ERO's operations, activities, oversight, and procedures.²⁵ The Commission is required to review the ERO's performance and issue an order finding either that the ERO meets the statutory and regulatory criteria or directing the ERO to come into compliance with or improve its compliance with the requirements of Part 39 of our regulations.²⁶ Below, the Commission addresses information pertaining to the criteria listed in section 39.3(b), along with additional information submitted in the Performance Assessment and addresses areas for improvement by the ERO where appropriate.

34. Our discussion of NERC's Performance Assessment is divided into the following major topics: (i) evaluation of NERC's and the Regional Entities' continued satisfaction of the certification criteria; (ii) evaluation, by program area, of NERC's achievements, proposed action items and additional areas for improvement; and (iii) Regional Entity issues.

35. For the reasons discussed in detail below, we accept NERC's Performance Assessment pursuant to section 39.3(c)(1) of our regulations. Pursuant to section 39.3(c)(2), we find that NERC continues to satisfy the statutory and regulatory criteria for ERO certification. Likewise, we find that each of the eight Regional Entities meets the relevant statutory and regulatory criteria. In addition, we find that further improvement is warranted not only as outlined by NERC in its filing but also with respect to the specific concerns we discuss below. The Commission, therefore, directs NERC to submit an informational filing addressing the specific matters identified below regarding the activities of the ERO and the Regional Entities. The Commission also directs NERC to undertake several other specific actions, as discussed below.

36. NERC's Performance Assessment identifies over 120 action items to improve its operations. Of particular note, NERC's Performance Assessment provides a combined analysis regarding the Regional Entities' satisfaction of statutory and regulatory criteria

²⁵ 18 C.F.R. § 39.3(c)(1)(ii).

²⁶ 18 C.F.R. § 39.3(c)(2).

along with a more detailed analysis region by region on certain topics. For future assessments, a separate section assessing each Regional Entity's satisfaction of statutory and regulatory criteria, and a more detailed discussion of stakeholder comments regarding each Regional Entity in the ERO assessment process, will aid the Commission in making a determination on whether each of the Regional Entities is performing properly under its delegated authority.

A. Satisfaction of the Criteria for Certification as the ERO and Evaluation of the Regional Entities

37. Under section 215(c) of the FPA and section 39.3(b)(1) of the Commission's regulations, the ERO must demonstrate that it has the ability to develop and enforce Reliability Standards that provide for an adequate level of Bulk-Power System reliability.²⁷ In addition, the ERO must show that it has established rules that: (i) assure independence, while assuring fair stakeholder representation and balanced decision-making; (ii) equitably allocate reasonable dues, fees and other charges; (iii) provide fair and impartial procedures for enforcing Reliability Standards through imposition of penalties; (iv) provide reasonable notice and opportunity for public comment, due process and balance in developing Reliability Standards and otherwise exercising its duties; and (v) provide appropriate steps to gain recognition in Canada and Mexico.²⁸

38. NERC also must evaluate the Regional Entities' effectiveness, including recommendations for improvement suggested by NERC, users, owners and operators of the Bulk-Power System, in accordance with the requirements contained in the Commission's regulations at 18 C.F.R. § 39.3(c)(1)(iii).

NERC Performance Assessment

39. NERC states that it satisfies the statutory and regulatory requirements on an ongoing basis, including establishing rules to support its programs and functions as contemplated and required by the enabling legislation, regulations, and orders approving various aspects of NERC's structure, processes and rules. NERC provides a detailed narrative describing how it satisfies the statutory and regulatory requirements for certification on an ongoing basis.

²⁷ 18 C.F.R. § 39.3(b)(1).

²⁸ 18 C.F.R. § 39.3(b)(2).

40. As the ERO, NERC states that it has delegated certain authorities to the eight Regional Entities. These authorities include: (i) regional Reliability Standards development; (ii) compliance monitoring and enforcement, including registration of organizations; and (iii) other services in support of NERC's statutory reliability functions including reliability assessments, event analysis, and training and education activities. NERC states that the implementation of the ERO's statutory responsibilities through the delegation agreements generally has been successful and that the greatest efforts to date have been in the organization registration and Compliance Monitoring and Enforcement Programs (CMEPs).

41. NERC provides a detailed evaluation of the Regional Entities' effectiveness and recommendations for improvement, as required by the Commission's regulations.²⁹ The Regional Entities also provided a joint evaluation, self-evaluations and suggestions for improvements.³⁰

1. Development and Enforcement of Reliability Standards, Section 39.3(b)(1)

42. With regard to the requirement that the ERO develop Reliability Standards that provide for an adequate level of Bulk-Power System reliability, NERC notes that since the Commission certified it as the ERO, the Commission has approved 95 continent-wide Reliability Standards as mandatory and enforceable within the continental United States. These 95 Reliability Standards encompass a broad range of reliability topics. NERC states that its Commission-approved, American National Standards Institute (ANSI)-accredited and stakeholder-driven Reliability Standards Development Procedure establishes a rigorous set of technical, content and format requirements designed to produce technically excellent, consensus-based Reliability Standards. NERC indicates that it continues to identify and prioritize the need for new Reliability Standards and revisions to existing Standards.

43. NERC states that it and the Regional Entities have developed and implemented a comprehensive program for monitoring and enforcing compliance with the mandatory Reliability Standards. NERC and the Regional Entities have registered over 1,800 users, owners and operators of the Bulk-Power System that are responsible for compliance with mandatory Reliability Standards. NERC and the Regional Entities have developed

²⁹ See Performance Assessment, Att. 3.

³⁰ See Performance Assessment, Att. 4.

programs to monitor and enforce compliance with Reliability Standards, and the Commission has approved NERC's *pro forma* CMEP and the CMEP applicable to each Regional Entity. Compliance is monitored pursuant to an array of compliance processes, including audits, spot checks, self-certifications and compliance violation investigations.³¹

2. Certification Criteria under Section 39.3(b)(2)

a. Independence and Fair Stakeholder Representation

44. NERC states that its Bylaws provide for a Board of Trustees consisting of ten independent trustees plus the President of NERC.³² The Member Representatives Committee, which is a committee of NERC members' representatives who are selected by the members of the respective membership sectors established by the Bylaws, elects the Trustees. The Board appoints NERC committees, in accordance with the Bylaws and Rules of Procedure, that are representative of members, other interested parties, and the public, that provide for balanced decision-making and that include persons with outstanding technical knowledge and experience. Committee composition (except in certain committees organized on other than a membership-sector basis) must ensure that no two stakeholder sectors are able to control the vote on any matter and that no single sector is able to defeat a matter.

b. Equitable Allocation of Reasonable Dues, Fees and Other Charges

45. NERC explains that, according to the NERC Bylaws, Rules of Procedure, and delegation agreements, the annual funding requirements for the "statutory" activities of NERC and the Regional Entities are allocated based on net energy for load.³³ These

³¹ See generally Performance Assessment, Att. 1 (detailing NERC's development of Reliability Standards that provide for an adequate level of Bulk-Power System reliability).

³² After NERC filed its assessment in this proceeding, the Commission approved NERC's proposal to expand its Board of Trustees to eleven independent trustees, plus NERC's president. *North American Electric Reliability Corp.*, 129 FERC ¶ 61,038 (2009).

³³ The Commission has stated that "anything required of the ERO or a Regional Entity by the statute, Order No. 672 pursuant to the statute, or any subsequent Commission order pursuant to section 215 of the FPA is a statutory activity" for purposes

(continued...)

allocations are collected by load-serving entities and their designees. NERC states that allocating costs based on net energy for load is an appropriate approach because it allocates the costs among all end users, ensures that no one pays twice, and is relatively simple to administer.³⁴ Further, NERC indicates that, with one exception pertaining to Canadian provinces, it has used net energy for load to allocate its net funding requirements among these entities in all of its business plan and budget filings.

c. **Rules that Provide Fair and Impartial Procedures for Enforcing Reliability Standards Through Imposition of Penalties**

46. NERC states that it has established rules that provide fair and impartial procedures for monitoring and enforcement of compliance with Reliability Standards, set forth in Section 400 of the NERC Rules of Procedure, NERC's CMEP, and the individual CMEP of each Regional Entity.

47. According to NERC, the CMEP includes provisions allowing registered entities to participate in settlement discussions with NERC or the Regional Entity related to notices of alleged violations, proposed penalties or sanctions, and mitigation plans. NERC also states that the uniform CMEP includes rules regarding the determination and imposition of financial penalties on registered entities that have violated Reliability Standards. NERC states that its Rules also include hearing procedures pursuant to which a registered entity can dispute an alleged violation.

48. NERC has adopted Sanction Guidelines, which the Commission has approved, that provide for setting penalties based on Violation Risk Factors and Violation Severity Levels. The Sanction Guidelines also identify mitigating or aggravating circumstances that may be considered in assessing a penalty, such as the entity's compliance history, whether the entity self-reported the violation, the quality of the entity's internal compliance program, and other factors.³⁵

of mandatory funding of ERO and Regional Entity functions. *See North American Electric Reliability Corp.*, 117 FERC ¶ 61,091, at P 28 (2006).

³⁴ Performance Assessment, Att. 2 at 62.

³⁵ Performance Assessment at 63-64.

d. Rules that Provide Notice and Opportunity for Public Comment, Due Process and Balance in Developing Reliability Standards and Otherwise Exercising Duties

49. NERC states that its Bylaws, Rules of Procedure and Reliability Standard Development Procedure establish rules that provide for reasonable notice and opportunity for public comment, due process, openness and balance of interests in developing Reliability Standards.³⁶ According to NERC, participation in the development of Reliability Standards is open to all persons who are directly and materially affected by the reliability of the North American Bulk-Power System, with no undue financial barriers to participation. NERC's ballot body for voting on proposed Reliability Standards is organized in ten segments to reflect a balance of interests.

50. NERC provides a detailed description of the stages in the Reliability Standards development process. NERC states that it posts proposed new or revised Reliability Standards for public comment, and the standard drafting team must address any comments received. After this process is complete, the ballot pool for that Reliability Standard votes on the final proposed new or revised Standard. Approval of a proposed new or revised Reliability Standard requires both a quorum, consisting of 75 percent of the ballot pool membership submitting a vote, and an affirmative vote by a two-thirds majority of the weighted-segment votes. In addition, NERC notes that the Regional Entities have adopted a Regional Reliability Standards Development Procedure that meets NERC's "comprehensive set of 34 essential attributes for Standards development procedures."³⁷

e. Appropriate Steps to Gain Recognition in Canada and Mexico

51. NERC states that it has made significant process in obtaining recognition in Canada. Specifically, as of July 1, 2009, NERC has been recognized as the ERO in the provinces of Alberta, Manitoba, New Brunswick, and Ontario. NERC also has entered into agreements or memoranda of understanding with the appropriate provincial authorities in New Brunswick, Nova Scotia, Québec, and Saskatchewan defining NERC's and the Regional Entities' roles in the province with respect to reliability

³⁶ See Performance Assessment, Att. 1, at 32-38; NERC Rules of Procedure, Section 300 (Reliability Standards Development) and Appendix 3A (Reliability Standards Development Procedure).

³⁷ Performance Assessment at 64-65.

matters. NERC also has signed a memorandum of understanding with the Canadian National Energy Board, which has jurisdiction over international transmission lines. According to NERC, Alberta, British Columbia, Manitoba, New Brunswick, Ontario and Saskatchewan have made Reliability Standards mandatory.

52. NERC advises that there currently is no legislative authority in Mexico for any regulatory authority to recognize NERC as the ERO or to exercise regulatory authority over reliability matters. However, the Comisión Federal de Electricidad, which is responsible for reliable operation of the electric system in Mexico, is a signatory to the WECC Reliability Management System Agreement with respect to the portion of the grid in Baja California Norte that is part of the Western Interconnection.

Comments

53. EEI comments that NERC has a strong record of achievement in its implementation of its duties as the ERO and, based on this record, EEI believes that NERC is successfully carrying out its statutory and regulatory responsibilities as the ERO. Exelon and EPSA also comment generally that NERC is meeting the requirements of section 39.3(b) of the Commission's regulations and fulfilling its statutory and regulatory responsibilities as the ERO.

Commission Conclusion

54. We find that NERC has demonstrated that it satisfies the statutory and regulatory requirements set forth in section 215(c) of the FPA and section 39.3(b) of our regulations. As described above, NERC has provided a detailed description of how it meets the statutory and regulatory requirements. Further, NERC's Rules of Procedures, including its Reliability Standards development process and CMEP are, in the main, the same as those previously approved by the Commission in the proceeding in which the Commission certified NERC as the ERO.³⁸ The Commission has specific concerns about certain aspects of NERC's Reliability Standards development program and Compliance Monitoring and Enforcement Program, which we discuss in a separate section below. Nonetheless, for purposes of this proceeding, we conclude that NERC has demonstrated that it has the ability to develop and enforce Reliability Standards.

55. We also find that each of the Regional Entities continues to meet the relevant statutory and regulatory criteria. In general, we agree with NERC that the

³⁸ ERO Certification Order, 116 FERC ¶ 61,062 at P 3, 250.

implementation of the ERO's statutory responsibilities through the delegation agreements has been successful. However, the Commission does have concerns about certain aspects of the Regional Entities' performance, as detailed below. The Commission recognizes that, as with NERC's initial activities as the ERO, the Regional Entities have undergone a period of transition during their initial years of operation under the delegation agreements. During this period, the Regional Entities have been tasked with implementing a complex and evolving regulatory system of great importance to the nation and, in response, have significantly increased their staffs, budgets and the scope of their activities. The Regional Entities currently reflect these changes, which have transformed their operations and improved their ability to conduct the functions NERC delegated to them. The Regional Entities generally have operated in the manner envisioned when the Commission originally approved the delegation agreements.

56. With regard to the equitable allocation of reasonable dues, fees and other charges, we agree with NERC that allocation based on net energy for load is a reasonable and equitable allocation method.³⁹ We believe that NERC's use of the net energy for load methodology is well justified, and we note the history of using the net energy for load method for collecting ERO funding, its acceptance by the courts, its equitable benefits (including the elimination of double counting), and its relatively simple application compared to other apportionment methods. Further, we believe that NERC's budget development process, and the Commission's approval of the ERO and Regional Entity annual business plans and budgets support the reasonableness of the charges.

57. Likewise, the Commission generally is satisfied with other features of NERC's Rules of Procedure, including rules that provide fair and impartial procedures for enforcing Reliability Standards and rules that provide for broad participation, notice and opportunities for comment in developing Reliability Standards. NERC should continue to seek recognition in Canada and Mexico, as appropriate and keep the Commission informed about the status of those efforts.

B. Evaluation of NERC's Achievements, Program Areas, Proposed Actions Items, and Additional Areas for Improvement

58. In addition to discussing how NERC meets the regulatory and statutory requirements, the Performance Assessment evaluates each of NERC's program areas,

³⁹ See, e.g., Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 213; ERO Certification Order, 116 FERC ¶ 61,062 at P 167; *North American Electric Reliability Corp.*, 128 FERC ¶ 61,025, at P 38 (2007).

describing achievements, stakeholder feedback, and actions items that NERC will implement to address specific concerns. NERC's discussion of the achievements and needed improvements for each program areas is thorough and thoughtful. We generally support the many action items identified by NERC to improve the program areas, except where we specifically discuss a proposed action item and take issue with it. Below, we identify and discuss NERC's successes, challenges, and opportunities for improvement in the following areas: (1) development of Reliability Standards; (2) compliance monitoring and enforcement; (3) critical infrastructure protection; (4) compliance registry; (5) situational awareness; and (6) business planning and budgeting, accounting and financial reporting and assessment processes. However, before addressing these issues, we address some general comments to the Performance Assessment submitted in this proceeding.

59. EEI comments that it generally supports the specific action items outlined by NERC, but notes that the document is unclear on which of the proposed actions are responsive to stakeholder comments, which are actions that already are recognized as needed or in progress, which are actions NERC staff is proposing independently or whether the actions are tied to ongoing reviews under NERC committees. EEI recommends that NERC develop a "report card" consisting of a final list of key action items listed in NERC's Performance Assessment, which will be the foundation for the next periodic assessment process, and characterize each item on the list as a low, medium or high priority. EEI believes this would better inform management and budget decision-making and improve the ability to measure NERC's performance and accountability. The report card also would inform prioritization for business planning purposes, and help justify budget increases to state regulatory authorities and stakeholders as providing for improved reliability. EEI suggests that the final action items for the report card should be developed in consultation with the appropriate NERC committees.

60. EEI comments that the NERC Three-year Assessment process provides an opportunity to consider the relationship between the Commission, the ERO and the owners, users and operators of the Bulk-Power System, and urges the Commission to ensure NERC's continued strength and independence as the ERO. EEI offers the observation that "the role played by the Commission has blurred the framework for a strong and independent ERO."⁴⁰ EEI asserts, as an example, that the Commission's directives in its orders on Reliability Standards are too detailed and prescriptive, not giving due weight to the technical expertise of the ERO. While EEI recognizes the

⁴⁰ EEI Comments at 7.

Commission's authority and responsibility to initiate certain enforcement actions resulting from system events, EEI believes that the Commission should work cooperatively with NERC on such investigations and, wherever possible, allow NERC to take the lead in investigating such incidents and enforcing any violations.⁴¹

61. Likewise, various stakeholders have expressed concern that the Commission's involvement in NERC's processes potentially undermines NERC's independence. For example, some stakeholders believe that the Commission directives regarding Reliability Standards are too detailed and prescriptive and do not give due weight to the ERO's technical expertise. Similarly, in the Performance Assessment, NERC discusses stakeholder criticism about Commission staff's involvement and influence in the Reliability Standard development process. NERC also discusses the evolving relationship of Commission, NERC, and stakeholder involvement in the Reliability Standards development process, noting the Commission's active involvement in development, as well as the stakeholders' preference for a more independent, self-regulatory development model.⁴²

Commission Conclusion

62. EEI expresses concern that the Performance Assessment fails to identify the source of a particular action item, i.e., stakeholder comments, NERC staff proposal, etc. We believe that NERC has appropriately presented the action items by substantive topic and explained the concerns each action item is intended to address. Specifically, Appendix A to the Performance Assessment includes a summary of issues raised by stakeholders and NERC's proposed action to address that item, and Attachment 2 to the Performance Assessment details the proposed actions. Further, EEI recommends that NERC develop a "report card" to rank and track NERC's action items. NERC, in the Performance Assessment, states that it plans to develop schedules, resource allocations and tracking mechanisms necessary to implement the action items.⁴³ Thus, we leave to NERC's discretion whether it is worthwhile to develop a "report card" as proposed by EEI. However, to aid the Commission in its efforts to support NERC in its implementation of the various action items proposed in the Performance Assessment, we

⁴¹ *Id.*

⁴² Performance Assessment, Att. 2 at 9.

⁴³ Performance Assessment, App. A at 1.

direct NERC to submit an informational filing six months from the date of this order updating the Commission on NERC's progress in prioritizing and implementing the various action items.

63. With regard to EEI's concerns regarding the Commission's role, we disagree that our orders or actions have compromised NERC's independence or weakened NERC as the nation's ERO. ERO independence pertains to the ERO's independence from the users, owners and operators of the Bulk-Power System that are subject to mandatory Reliability Standards.⁴⁴ For the ERO to function properly in its role of developing and enforcing Reliability Standards, it is essential that the ERO remain independent from stakeholders as set forth in section 215(c) of the FPA. In contrast, Congress explicitly conveyed authority to the Commission to oversee and review the ERO's activities within the United States. In particular, section 215 of the FPA authorizes the Commission to approve or remand a Reliability Standard proposed by the ERO and authorizes the Commission to direct the ERO to address specific reliability issues identified by the Commission. Likewise, the statute requires that the ERO file a penalty assessment with the Commission, with the potential for Commission review, prior to a penalty taking effect. In addition, section 215(e) authorizes the Commission to take enforcement action, independent from the ERO, when it believes that an entity may have violated a Commission-approved Reliability Standard. EEI's criticisms based on the Commission's fulfilling its statutory role are misplaced.

64. With regard to EEI's specific examples, we previously have addressed concerns that directives are too detailed or prescriptive. In Order No. 693, in response to similar comments, the Commission explained:

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. 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.

⁴⁴ 16 U.S.C. 824o (c)(2)(a).

Without such direction and guidance, a Commission proposal to modify a Reliability Standard might be so vague that the ERO would not know how to adequately respond.⁴⁵

65. Further, the Commission stated that, when directing the ERO to address a proposed Reliability Standard or a modification to a Reliability Standard that addresses a specific matter pursuant to section 215(d)(5) of the FPA, where the order identifies a concern and offers a specific approach to address the concern, the Commission will consider an 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.⁴⁶ We emphasize that "the discussion we provide with our directives is for the purpose of providing guidance to assist the ERO in exercising its technical expertise during the Standards Development Process, not for the purpose of excluding that expertise."⁴⁷

66. The Commission agrees with EEI that, where a joint investigation of a system event is appropriate, the Commission and ERO staff should work cooperatively, and we believe this has occurred to date.⁴⁸ Whether the Commission or the ERO should take the lead in a particular investigation, or whether the Commission should commence an independent investigation, is a matter that must be determined on a case-by-case basis. Such decisions, however, do not compromise the independence of NERC as the ERO.

1. Development of Reliability Standards

67. The development of Reliability Standards is a fundamental responsibility of the ERO, and the Commission commends NERC on its efforts and progress in moving the

⁴⁵ *Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242 at P 185, *order on reh'g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

⁴⁶ *Id.* P 186.

⁴⁷ North American Electric Reliability Corporation, 132 FERC ¶ 61,218 at P 54.

⁴⁸ *See 2008 Florida Blackout*, 122 FERC ¶ 61,244 (2008) (When commencing a formal, non-public investigation of the 2008 Florida system event, the Commission states that its staff will investigate in full coordination with any analysis or investigations conducted by NERC or the Regional Entity).

industry from a voluntary to a mandatory Reliability Standards environment. We encourage NERC to continue its efforts to improve its process for developing high quality Reliability Standards. That said, the Commission has identified several areas of improvement that NERC should pursue in its efforts to fulfill its statutory responsibility to develop Reliability Standards to improve and protect Bulk-Power System reliability. Areas for improvement within the realm of the ERO's responsibility include: (a) the quality of proposed Reliability Standards, (b) time required to develop Reliability Standards, (c) NERC staff's technical capability, and (d) the prioritization of Reliability Standards development. We discuss each of these topics in turn below.

a. Quality of Proposed Reliability Standards

NERC Performance Assessment

68. NERC states that it provides guidance to the Reliability Standards drafting teams on how to achieve the quality objectives required to satisfy the criteria for "technically excellent" Reliability Standards.⁴⁹ NERC states that, using its ANSI-accredited and Commission-approved Reliability Standards Development Procedure, it has developed a comprehensive body of Reliability Standards for the Bulk-Power System.⁵⁰ NERC also states that its annual planning tool, its Reliability Standards Development Plan (Development Plan), has as an objective to address quality issues to ensure that each Reliability Standard has a clear statement of purpose and clear and measurable requirements.

69. NERC notes that as of May 31, 2009, there has been limited activity by Regional Entities in developing regional Reliability Standards, and only one Regional Entity, WECC, has developed and obtained NERC and Commission approval of any regional Standard. Several other Regional Entities have regional Standards at various stages of development, but none of these projects has advanced to the point of obtaining NERC and Commission approval.⁵¹

70. Noting the Commission's concern that NERC's Reliability Standards development process could risk producing least-common denominator Standards, NERC

⁴⁹ Performance Assessment, Att. 1 at 45.

⁵⁰ Performance Assessment at 13.

⁵¹ Performance Assessment, Att. 3 at 6.

acknowledges that a consensus-based Reliability Standards development process has the potential to produce Standards that are less than what some may view as the best approach in a particular situation to ensure reliability. However, NERC contends that this outcome is not happening due to industry participants' interests in ensuring strong reliability practices both on their own behalf and on the part of their neighbors.

71. NERC also indicates that it would take action to reinforce with its Reliability Standard drafting teams that they must develop an approach consistent with Commission directives, or, alternatively, an equal and effective approach to that identified by the Commission.⁵²

Comments

72. EEI expresses concern about ambiguities in the existing Reliability Standards. According to EEI, the increasing use of NERC's interpretation process is a symptom of a core problem regarding differences of opinion over the specific meaning of various requirements and of how to demonstrate compliance. EEI asserts that stakeholders broadly share this perception and therefore, recommends that this issue should have a high priority for the year ahead.

Commission Conclusion

73. In the ERO Certification Order, the Commission recognized that each Reliability Standard must be technically sound and designed to achieve a reliability goal.⁵³ As summarized above, NERC represents that the Reliability Standards Development Process is intended to produce "technically excellent" Standards, and considers quality issues including clear and measurable requirements.

74. The Commission appreciates NERC's efforts in this area. We, however, remain concerned about the ability of the NERC Reliability Standards Development Process to develop high quality Reliability Standards that not only protect, but improve, the reliable operation of the Bulk-Power System. The development of such high quality Reliability Standards is absolutely essential to meeting these goals, providing a clear roadmap for industry to comply with reliability requirements and allowing NERC, the Commission and international regulators to monitor this compliance. In order to accomplish this goal,

⁵² Performance Assessment, Att. 2 at 10.

⁵³ ERO Certification Order, 116 FERC ¶ 61,062 at P 239.

we have urged NERC to take certain measures, including hiring staff with the technical capability to independently advise the NERC Board of Trustees regarding the substantive content of proposed Reliability Standards.⁵⁴

75. We share EEI's concerns that ambiguities should be minimized in Reliability Standards to the extent possible. The 95 Commission-approved Reliability Standards contain over 700 requirements and may not clearly account for every variation of compliance scenario. NERC should continue to work to address concerns regarding the clarity of Reliability Standards, and several NERC action items will address this concern. In particular, NERC compliance with the outstanding directives of prior Commission orders, such as Order No. 693, will improve the clarity of Reliability Standards.

76. We encourage NERC, as the entity ultimately responsible for the quality of regional Reliability Standards, to exercise strong oversight to ensure that all regional Reliability Standards developed are necessary and justified. NERC's goal and practice in guiding and communicating with the Regional Entities and stakeholders should be uniformity of Reliability Standards, as uniformity encourages best practices and enhances reliability. NERC also should lead the Regional Entities in their development efforts to ensure consistency and quality in regional Reliability Standards. We direct NERC to consider the following practices for use during the Standards development process as possible means to accomplish these objectives: (1) posting proposed regional Reliability Standards for comment from the continent-wide pool of interested stakeholders for consideration, while allowing the regional open processes to make final determinations to be submitted to NERC; (2) providing for comments from NERC technical staff on proposed regional Reliability Standards; and (3) including regional Reliability Standards in other NERC review processes that it uses for continent-wide Reliability Standards. We further direct NERC to discuss its considerations regarding these suggestions in the informational filing due six months from the date of this order.

b. Time Required to Develop Reliability Standards

77. In Order No. 672, the Commission stated that the ERO's Reliability Standards development process must not unnecessarily delay development of proposed Reliability Standards.⁵⁵

⁵⁴ *E.g.*, *North American Electric Reliability Corp.*, 125 FERC ¶ 61,056, at P 24 (2008) (NERC 2009 Budget Order); *see also North American Electric Reliability Corp.*, 130 FERC ¶ 61,203, at P 26-27 (2010).

NERC Performance Assessment

78. NERC states that one of its objectives is to develop Reliability Standards and revise existing Standards in a timely manner that is responsive to new and changing priorities for and threats to the reliable operation of the Bulk-Power System. NERC states that based on its analysis, the average duration for completing Reliability Standards projects from the initial Standards Authorization Request to approval of the new or modified Standard by the NERC Board has been 21.7 months, with a median duration of 17.7 months, a minimum duration of 1.6 months, and a maximum duration of 80.5 months.⁵⁶

79. NERC acknowledges in its assessment the extended length of time it has taken to complete projects and agrees with stakeholders that enhanced project management skills by team leaders and NERC staff coordinators would help mitigate this concern. In response to stakeholder comments, NERC has developed several action items intended to expedite Reliability Standards development and reduce resource requirements on it and the industry.⁵⁷ For example, NERC states that it will: (i) permit drafting teams to use “informal” comment periods for feedback on concepts; (ii) permit multiple initial ballots without multiple 30-day review periods; (iii) eliminate or modify steps in the development process that are not required by ANSI; (iv) allow a streamlined process to correct a narrow, single issue; (v) utilize technical writers; and (vi) allow NERC staff to provide a “straw man” draft of a proposed Standard in advance of a drafting team’s first meeting.

Comment

80. Noting that speed and quality can at time be at odds, EPSA supports NERC’s suggested reforms to streamline the Reliability Standards development process and believes that the reforms allow for sufficient industry review, “while keeping the process moving.”

⁵⁵ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 258.

⁵⁶ Performance Assessment, Att. 1 at 55.

⁵⁷ Performance Assessment, Att. 2 at 6-8.

Commission Conclusion

81. In the ERO Certification Order, the Commission expressed concern regarding the time it may take to develop a Reliability Standard.⁵⁸ In its application for certification as the ERO, NERC indicated that under its usual ANSI-accredited process in effect at the time, a Reliability Standard may be developed in as little as four months, or up to 12 to 15 months for a more complex Standard.⁵⁹ However, the NERC analysis submitted in this docket indicates that, in practice, it has taken considerably longer, an average processing time of 21.7 months, to develop Reliability Standards. The average processing time is even longer if “urgent action” Standards are not considered. Given this analysis, the Commission continues to have some concerns regarding NERC’s ability to timely develop Reliability Standards.⁶⁰

82. Having noted these concerns, we are encouraged by the multiple action items that NERC intends to implement or has already implemented to improve the time required to develop Reliability Standards.

83. In June 2010, NERC submitted a petition seeking approval to replace in its entirety Version 7 of its Reliability Standards Development Procedure with a new Standard Processes Manual.⁶¹ A number of the actions identified by NERC in the three-year assessment that relate to Reliability Standards development are addressed in NERC’s June 2010 filing. For example, NERC proposed to allow drafting teams to use informal comment periods for feedback and elimination of certain process steps that are

⁵⁸ ERO Certification Order, 116 FERC ¶ 61,062 at P 252; *see also North American Electric Reliability Corp.*, 118 FERC ¶ 61,030, at P 19 (2007).

⁵⁹ ERO Certification Order, 116 FERC ¶ 61,062 at P 252.

⁶⁰ Additionally, we note that approximately 15 percent of the Order No. 693 directives have been completed to date. This gives us some concerns about NERC’s ability to timely develop new or modified Reliability Standards in response to Commission directives. Below, the Commission provides guidance on how NERC can prioritize its work in responding to directives. *See infra* P 101.

⁶¹ The NERC June 2010 submission is designated as Docket No. RR10-12-000.

not required by ANSI. In a September 3, 2010 order, the Commission approved NERC's June 2010 filing and directed NERC to submit a compliance filing.⁶²

84. In a January 2007 order addressing a NERC compliance filing in the proceeding pertaining to NERC's certification as the ERO, the Commission directed NERC to submit quarterly reports for a three-year period regarding the effectiveness the Reliability Standards Development Process.⁶³ The report requires NERC to analyze quarterly voting results, including trends and patterns that may signal a need for improvement in the voting process.

85. While we are encouraged by NERC's efforts to revisit its Standards Development Process, we believe that it is important that the Commission continue to monitor the effectiveness of the Reliability Standards Development Process and, therefore, renew the directive that NERC submit quarterly reports for an additional three years from the date of this order. In addition to the contents described in the January 2007 order, the quarterly reports must include separate analyses of: (i) the time required to complete projects (i.e., excluding urgent action projects); (ii) the time required to complete projects initiated in response to NERC's urgent action progress (including whether or not a permanent fix was implemented within the sunset period);⁶⁴ and (iii) the time required to complete projects in response to Commission directives. The analysis should include data on the time required for each stage of the process. For example, the analysis should document the time required to move a proposed Reliability Standard from a Standards Authorization Request to the NERC Board, and then to the Commission. Accordingly, the Commission directs NERC to continue to file quarterly reports as required by the January 18, 2007 Order within 30 days of the end of each quarterly period, beginning with the fourth quarter of 2010, through and including the fourth quarter of 2013.

⁶² See *North American Electric Reliability Corp.*, 132 FERC ¶ 61,200 (2010).

⁶³ In a January 18, 2007 Order, the Commission required NERC to closely monitor and report to the Commission its analysis of the voting results, including trends and patterns that may signal a need for improvement in the voting process for NERC Reliability Standards each quarter over a three-year period, commencing in 2007. *North American Electric Reliability Corp.*, 118 FERC ¶ 61,030 at P 18.

⁶⁴ NERC Rules of Procedure, sections 308 and 309, and Appendix 3A at 28.

c. **NERC Staff's Technical Capability**

NERC Performance Assessment

86. NERC indicates that it continues to rely on volunteer industry experts with the support of NERC staff. The NERC Standards Committee, which is industry based and chaired, provides oversight of the Reliability Standard drafting teams. NERC states that the Reliability Standards Development Process relies on industry volunteers to staff drafting teams and “leverages” the expertise of those teams to develop Reliability Standards, and that the Standards Committee supports execution of the Standard’s work plan. NERC states that industry technical experts and other industry volunteers perform a substantial role in Reliability Standards development. NERC emphasizes that NERC’s Standards program staff must collaborate with the Standard drafting teams and the Standards Committee to achieve its objectives.

87. NERC explains that NERC staff facilitates and assists in the Reliability Standards Development Process.⁶⁵ NERC also states that NERC’s Standards Process Managers are responsible for ensuring “the integrity of the Reliability Standards development process and the consistency of quality and completeness of NERC reliability standards.”⁶⁶ In addition, NERC states that the NERC Board of Trustees believes “it is important to have NERC staff provide the Board a technical evaluation of Reliability Standards presented for adoption, including assurance that the proposed Reliability Standards can be complied with and are auditable....”⁶⁷

Commission Conclusion

88. We agree with NERC’s recognition of the important role played by NERC staff in advising the NERC Board and ensuring the integrity of the Reliability Standards development process and the consistency of quality and completeness of NERC Reliability Standards. Such activities are consistent with the Commission’s 2009 Budget Order, in which the Commission stated that NERC, as the ERO, ultimately is responsible for the Reliability Standards development process, as well as for the quality and content

⁶⁵ Performance Assessment at 15; Performance Assessment, Att. 1 at 52.

⁶⁶ Performance Assessment, Att. 1 at 6.

⁶⁷ Performance Assessment, Att. 2 at 10.

of Reliability Standards proposed for Commission approval.⁶⁸ The Commission also found that NERC requires greater subject matter expertise to support its Reliability Standards development activities and that, at a minimum, NERC should have access to experts familiar with each of the categories of Reliability Standards that it develops and enforces. On clarification, the Commission explained that NERC should have adequate staff to (i) provide technically informed analysis, advice, and recommendations to the Standards Authorization Request drafting teams and Reliability Standards drafting teams; and (ii) provide independent analysis, advice and recommendations, both procedural and technical, to the NERC Board.⁶⁹

89. NERC states that it has “provided for substantial resources for the Reliability Standards Development Program in its annual ERO business plan and budget,” including 12 full-time employees (FTEs) dedicated to the Reliability Standards Development Process in 2007, 15 FTEs in 2008, and 14.5 FTEs in 2009, as well as additional consultant resources.⁷⁰ NERC also indicates that it has 28 active Reliability Standards development projects and eight interpretations underway as of the Performance Assessment filing.⁷¹ Based on this work load, the Commission will continue to monitor whether the current staffing level is adequate to perform the substantive role intended by NERC in the Performance Assessment or by the Commission in previous budget orders.⁷²

⁶⁸ NERC 2009 Budget Order, 125 FERC ¶ 61,056 at P 24.

⁶⁹ *North American Electric Reliability Corp.*, 126 FERC ¶ 61,021, at P 10-12 (2009).

⁷⁰ NERC’s 2010 business plan and budget increased the Reliability Standards staff by three FTEs. *See North American Electric Reliability Corp.*, 129 FERC ¶ 61,040, at P 27 (2009) (NERC 2010 Budget Order). The Commission stated that NERC, at a minimum, should have access to subject matter experts familiar with each of the 14 categories of Reliability Standards. *Id.* P 28.

⁷¹ Performance Assessment, Att. 2 at 1.

⁷² We note that NERC recently filed its 2011 business plan and budget, which proposes to increase the number of FTEs for the Reliability Standards Program to 20.08 for 2011. *See North American Electric Reliability Corp.*, Request for Acceptance of 2011 Business Plans and Budgets of NERC and Regional Entities and for Approval of Proposed Assessments to Fund Budgets, Docket No. RR10-13-000 (filed

(continued...)

d. **Prioritization of Reliability Standards Development and Results-Based Standards**

90. NERC develops an annual Reliability Standards Development Plan, which NERC uses as a management tool that guides, prioritizes and coordinates revision or retirement of existing Reliability Standards and the development of new Reliability Standards.⁷³ The Development Plan provides a “rolling” three-year outlook on NERC Reliability Standards projects. The NERC Standards Committee assists NERC staff in prioritizing both new and revised Reliability Standard projects included in the Development Plan.

NERC Performance Assessment

91. NERC states that stakeholder feedback in developing the Performance Assessment suggests the need to develop a more systematic process for prioritizing Reliability Standards projects, focusing on Reliability Standards that will lead to the greatest improvement in Bulk-Power System reliability. As stated previously, NERC has about 30 Reliability Standards development projects underway. According to NERC, stakeholders indicate that the current number of projects is overwhelming the ability of many stakeholders to participate on drafting teams and comment on proposed Reliability Standards in the NERC process.

92. NERC states that, taken in the aggregate, the stakeholder comments suggest a need for NERC to review all existing Commission-approved Reliability Standards to: (i) eliminate Reliability Standards that are not essential to the reliability of the Bulk-Power System, (ii) reduce “less significant” Reliability Standards to a lesser category, such as operating guides or policies, and (iii) convert documentation-related requirements to compliance measures or some other component of Reliability Standards not subject to findings of violation or penalty.⁷⁴ NERC identifies as an action item “develop and begin implementing a plan that includes engagement of regulatory authorities to convert the

August 24, 2010). We will discuss staffing levels more fully in that proceeding.

⁷³ Performance Assessment at 16 and Att. 2 p. 2-3. NERC submits each three-year plan to the Commission as an informational filing. *See, e.g.*, North American Electric Reliability Corp., Informational Filing of 2010 Development Plan Pursuant to Section 310 of the NERC Rules of Procedure, Docket No. RM05-17-000 (filed Dec. 2, 2009).

⁷⁴ Performance Assessment, Att. 2 at 3.

existing set of Reliability Standards and requirements to a smaller set of critical performance-based Reliability Standards.”⁷⁵

93. Other action items include: (i) continue to use the annual Plan to prioritize and guide activities; (ii) identify administrative requirements in the current set of Reliability Standards as candidates to be removed; (iii) develop a list of currently outstanding Commission directives and a prioritization process that strikes a balance between regulatory directives, industry input and feedback from NERC program offices; and (iv) continue to use more broad-based initiative approaches that address “lessons learned” from event analyses.

94. Regional Entities also provided NERC with feedback on the need for prioritization. Regional Entities emphasized the need for NERC to finalize the performance requirements necessary for the development of regional fill-in-the-blank Reliability Standards.⁷⁶ NERC states that as of the filing of the Performance Assessment, Reliability Standard drafting teams are addressing 15 of 24 fill-in-the-blank Reliability Standards, and are slated to commence work on the remaining nine such Reliability Standards in 2010. NERC states that some stakeholders believe Regional Entities should refrain from developing regional Reliability Standards until NERC has finished its development of a continent-wide Reliability Standard on that topic. At the same time, NERC indicates that others believe the fill-in-the-blank Reliability Standards should be completed to eliminate potential gaps in reliability and provide certainty to the registered entities on the application of these Standards. NERC suggests that this issue falls within the broader category of prioritization of Standards development activities, and that NERC and the Regional Entities should jointly address the issue.⁷⁷

⁷⁵ *Id.* at 4. We note that the term “performance-based Reliability Standard” as used in the Performance Assessment has evolved since NERC filed the Performance Assessment. NERC currently uses the term “Results-Based Standards,” as discussed further herein.

⁷⁶ The fill-in-the-blank Reliability Standards require the regional reliability organizations to develop criteria for use by users, owners or operators within each region. The Commission has expressed concern regarding the potential for the fill-in-the-blank Reliability Standards to undermine uniformity. Order No. 693, FERC Stats. & Regs. ¶ 31,242 at P 298.

⁷⁷ Performance Assessment, Att. 3 at 7.

Comments

95. APPA, EPSA and NRECA support NERC's efforts to prioritize Reliability Standards development. APPA comments that it believes NERC is committed to revamping NERC's body of Reliability Standards to make them more performance-based and to reduce documentation requirements that may more appropriately be contained in guidance documents. APPA requests that the Commission support these efforts and afford NERC significant discretion in the development of specific plans to implement the proposed actions outlined in its Three-Year Assessment. APPA comments that many NERC programs, including Reliability Standards development, are too resource and procedurally intensive and, thereby, put a particularly severe burden on the many medium and small-size utilities.

96. Likewise, NRECA opines that the strain NERC places on industry resources limits effective Reliability Standards activities. NRECA comments that it doubts that industry, especially smaller entities, can continue supporting 30 to 40 Reliability Standard development drafting teams simultaneously at present staffing levels without prioritization. Therefore, NRECA advises that NERC and its members should focus on prioritizing and streamlining its processes and future efforts to ensure effective reliability of the Bulk-Power System. NRECA explains that the magnitude and scope of the existing Standards development activities may be too great and possibly counter-productive because NERC does not have a process in place to determine which of its identified projects should have greater significance vis-à-vis reliability enhancements in comparison to those projects that have less immediate impacts and benefits. In addition, NRECA supports NERC's action item to develop a prioritization process for Reliability Standards development that balances regulatory directives, industry inputs, and feedback on reliability performance from the event analysis, reliability assessment, and compliance programs.

97. EPSA states that Reliability Standards requirements with a material, demonstrable impact on the Bulk-Power System deserve the focused attention of NERC and industry. EPSA believes NERC should establish a systematic way of laying out Reliability Standards and their requirements, and eliminating documentation requirements that it believes burdens resources without producing material improvement to reliability. EPSA states that NERC should concentrate its Reliability Standards development efforts on new Standards and on eliminating duplicative requirements by either retiring or converting them into guidelines with lower level requirements.

Commission Conclusion

Prioritization

98. We agree that a process to prioritize NERC's development and interpretation of Reliability Standards is a critical step in NERC's continued development as a strong and effective ERO. NERC must be able to identify and address, with sufficient resources and in a timely fashion, those Reliability Standards that will lead to the greatest improvement in Bulk-Power System reliability.

99. We recognize that NERC is charged with a challenging task. As the ERO, NERC must address a wide range of subjects and produce detailed and technically complex Reliability Standards that achieve industry consensus. It must also respond to Commission directives to modify or develop new Reliability Standards to address specific matters. We realize that these responsibilities may make it difficult for NERC to discern which Commission directives or Reliability Standard development projects should receive the highest priority, and that the protracted and iterative nature of the Standards Development process may make it difficult to address priority items in a timely fashion.

100. We provide several other thoughts with regard to the prioritization of Reliability Standards projects to provide additional guidance to NERC's prioritization efforts. At a high level, the Commission believes that NERC (along with its stakeholders) should prioritize those Reliability Standards projects that, in its expert judgment, are the most critical to the reliability of the Bulk-Power System.

101. Of course, we expect that this prioritization will include a priority to address outstanding directives from prior Commission orders. The Commission recognizes that its directives can create difficulty for NERC when it comes to prioritizing Reliability Standards development work. With respect to currently outstanding directives, NERC should consider which outstanding directives are the most critical to the reliability of the Bulk-Power System. The outstanding directives that are most critical to ensuring reliability should be addressed first. We understand that these directives may be among the most difficult and take the most time to fully address. However, they also are the most important and provide the most value in terms of enhancing the reliability of the Bulk-Power System. NERC should then focus its attention on those directives that provide operational benefits to the system or concern transmission planning to ensure reliability in the future. Finally, NERC should address those directives that clarify documentation requirements or are administrative in nature. In summary, we expect that NERC will make it a priority to comply with the outstanding directives that are the most

critical to the reliability of the Bulk-Power System and not allow work on lower priority obligations to interfere with or delay compliance with the most critical outstanding directives.

102. In addition to determining its priorities with respect to outstanding directives, NERC also should determine whether there are new or modified Reliability Standards that would address identified gaps in the Reliability Standards that may belong in the high priority group of Reliability Standards to be developed. NERC should identify and address all of these prioritization matters when submitting its annual Reliability Standard Development plan, beginning with the plan for 2012.

103. In response to stakeholder comments, we agree that NERC and the Regional Entities should also plan to complete the fill-in-the-blank Reliability Standards, which remain pending from Order No. 693. We agree with NERC that setting priorities regarding fill-in-the-blank standards is an issue that should be resolved jointly by NERC and the Regional Entities.

104. We also recognize the concern expressed by NRECA and APPA, which is that stakeholders, and small entities in particular, have limited resources available for Reliability Standards development. We encourage NERC to continue reaching out to registered entities to provide expert volunteers on Reliability Standards drafting teams and to continue streamlining its procedures to aid in reducing the strain on industry resources overall.

105. We believe that improved prioritization of the Reliability Standards development process will alleviate some of the burdens discussed by NRECA and APPA, while allowing their members to continue to participate in the Reliability Standard development process and without jeopardizing the quality of Reliability Standards. We also agree with NERC that it should develop a list of all outstanding Commission Reliability Standards directives and a process for prioritizing them. This process must balance the Commission's directives and associated guidance, industry inputs, and feedback on reliability performance from the event analysis, reliability assessment, and compliance programs.⁷⁸ We expect that this process will aid in identifying projects of the highest importance to the reliability of the Bulk-Power System and allow NERC to work effectively with industry to strike the proper balance in maintaining optimum industry participation in the Reliability Standards development process.

⁷⁸ Performance Assessment, Att. 2 at 4.

Results-Based Standards

106. The Commission understands that the effort identified in the Performance Assessment as “performance-based Reliability Standards” has evolved into the “results-based standards” initiative publicly discussed at several NERC Board of Trustees meetings.⁷⁹ As described in the initial proposal presented to the NERC Board of Trustees, the purpose of the results-based standards initiative is to ensure that the Reliability Standards “can have the greatest possible positive effect on the reliability of the bulk power system.”⁸⁰ We certainly agree with this goal. Now that NERC has obtained some experience with developing and enforcing mandatory Reliability Standards, it is appropriate for it to assess whether the number and quality of the Reliability Standards are causing users, owners and operators of the Bulk-Power System to achieve national reliability goals effectively and efficiently.⁸¹ While NERC has not asked for approval of this initiative at this time, the Commission will offer some preliminary guidance as NERC begins to develop Reliability Standards that will serve as a “proof of concept” for this initiative.⁸² We stress that ultimately, the determination as to whether a revised Reliability Standard is consistent with FPA section 215 and Order No. 672 will be made based on the merits of the Reliability Standards as they are submitted for approval.

107. First, the revised Reliability Standards should incorporate the Commission’s directives from prior orders, such as Order Nos. 693 and 706 and other orders that address the substantive performance goals of the Bulk-Power System. These directives

⁷⁹ See Board of Trustees meeting agendas for November 5, 2009, February 16, 2010, and May 12, 2010 *available at* <http://www.nerc.com/filez/botmin.html>.

⁸⁰ Proposal to Develop Results-Based Reliability Standards, at 1 (Oct. 16, 2009) (presented to the NERC Board of Trustees), *available at* http://www.nerc.com/docs/standards/sar/Proposal_for_Development_of_Results-Based_Reliability_Standards_Draft_2009Oct19.pdf.

⁸¹ See Order No. 693, FERC Stats. & Regs. ¶ 31,242 at P 328.

⁸² We note that on July 26, 2010, NERC posted a Results-Based Reliability Standards Transition Plan to its website. See http://www.nerc.com/docs/standards/sar/RBS_Transition_Plan_2010July26_Final.pdf.

focus on the areas most critical to the Bulk-Power System and any revisions should ensure that these directives are met.

108. Second, we understand that the results-based standards initiative will strive to minimize administrative requirements, such as documentation, within the Reliability Standards and to convert such requirements to guidelines or compliance measures. The Commission will carefully examine any proposals to eliminate requirements to ensure that any such changes neither lessen the degree of reliability ensured by an existing approved Reliability Standard nor undermine enforceability. While it may be appropriate to move certain administrative requirements from a Reliability Standard to guidelines, others are necessary to measure compliance and should remain as mandatory elements of the Reliability Standard. Thus, NERC must clearly demonstrate that any proposed elimination of a requirement does not diminish the reliability and enforceability of the existing Reliability Standard. Most importantly, NERC and the Regional Entities cannot rely solely on post-event measurements of compliance.

109. Third, we understand that the proposed results-based standard format may include expanded background sections, expanded descriptions of a Reliability Standard's purpose, and/or explanations about the intent of individual Requirements. This information may provide useful context but it should not contradict or seek to supersede or interpret the requirements within a Reliability Standard. The requirements within the Reliability Standard should govern, and the application of the Standard should be clear without reference to the background or purpose sections.

110. Fourth, commenters suggest that the results-based standards initiative should strive to eliminate duplicative requirements by either retiring or converting them into guidelines with lower level requirements. However, a requirement cannot be retired without its associated reliability benefit being addressed fully in another requirement or Standard. We caution that the body of Reliability Standards approved by the Commission is designed to work collectively rather than as individual Reliability Standards so some overlap is necessary and some Reliability Standard objectives therefore will not be complete without other complimentary requirements or Standards.⁸³

⁸³ For example, it is appropriate to have the same requirement in Emergency Operations and Transmission Operations to ensure that the reliability objective is met in both areas.

111. Fifth, in Order No. 672, the Commission stated that there “should be a clear criterion or measure of whether an entity is in compliance” with a Reliability Standard.⁸⁴ To this end, revised standards should include objective language rather than subjective modifiers such as, but not limited to, “sufficient” or “adequate” or “reasonable business judgment.”⁸⁵ Similarly, Reliability Standards should not include language requiring NERC or a Regional Entity to assess whether a registered entity intended to violate a Standard, nor whether a registered entity failed to perform due to, for example, negligence or human error.⁸⁶

112. Last, and perhaps most importantly, revised Reliability Standards should not reduce Bulk-Power System reliability from that which would be required by the existing approved Standards. For example, if an existing Reliability Standard or requirement requires an entity to meet a specific reliability objective, a revised Standard or requirement should not reduce or eliminate that reliability objective unless it includes a requirement(s) that compels equivalent or greater Bulk-Power System reliability. The Commission will consider each proposed Reliability Standard under this initiative on a case-by-case basis.

2. Compliance Monitoring and Enforcement

113. In addition to discussing how NERC satisfies the statutory and regulatory criteria related to compliance monitoring and enforcement, NERC provides a detailed assessment of the Compliance Monitoring and Enforcement Program, including achievements, stakeholder concerns and specific action items to improve the program. NERC identifies

⁸⁴ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 327.

⁸⁵ See, e.g., discussion of the term “reasonable business judgment” in *Mandatory Reliability Standards for Critical Infrastructure Protection*, Order No. 706, 122 FERC ¶ 61,040, at P 106-138 (2008).

⁸⁶ Although the Standard should not include language requiring assessment of intent in determining whether a Standard has been violated, NERC and the Regional Entity may, in the penalty determination phase of its review, consider whether the subject entity intended to violate a Standard, and whether the entity failed to perform due to negligence or human error. See Sanction Guidelines of the North American Electric Reliability Corporation, effective Jan. 15, 2008 (Appendix 4B to the NERC Rules of Procedure) § 4.3.7, available at http://www.nerc.com/files/Appendix4B_Sanctions_Guidelines_Effective_20080115.pdf.

several issues regarding compliance monitoring and enforcement that apply to all the Regional Entities, and to NERC itself, and suggests a number of program enhancements the Regional Entities should make to improve their processing of alleged violations and mitigation plans, such as improving the speed of processing alleged violations and companion mitigation plans to completion. We generally support NERC's suggestions and discuss here several of the compliance monitoring and enforcement matters raised by NERC, including (a) audit practices; (b) penalty determinations; (c) delegation agreements; and (d) NERC's no-action letter proposal.

a. Audit Practices

i. Uniformity

114. Stakeholders commented that more NERC oversight and training of Regional Entity compliance audit teams could help improve the overall program.⁸⁷ Stakeholders stated that differences persist among Regional Entities in audit practices, including the timing and type of documentation requests, the quantity and level of detail in evidence accepted, and willingness to entertain alternative presentations of evidence. According to stakeholders, documentation found compliant by one audit team was found to be non-compliant by another audit team. Stakeholders also commented that compliance auditors often request more information without reasonable notice and without identification of the requirement to which the requested information relates. NERC states that stakeholders complained that some compliance auditors arrive on-site without having reviewed information and documentation supplied in response to pre-audit questionnaires and ask for material that already was provided.⁸⁸

115. NERC states that the Regional Entities currently maintain their own processes for self-certification and spot checking, but that it is NERC's and the Regional Entities' goal to push towards uniformity for these processes. This uniformity will help all industry participants, and in particular registered entities that operate in more than one Region.

116. In response to stakeholder and Regional Entity comments and recommendations, NERC intends to ensure more uniformity and consistency in audits between Regional Entities and between different audit teams. To accomplish this goal, NERC plans to undertake the following actions: (i) review the need for additional auditor training,

⁸⁷ Performance Assessment at 37.

⁸⁸ Performance Assessment, Att. 2 at 26-28.

including remedial training or counseling in cases where specific problems are identified; (ii) review existing templates or instructions for compliance audit reports to ensure they require specific discussion of how the registered entity demonstrated compliance and what evidence was lacking in determinations of non-compliance; (iii) continue to monitor the Regional Entities' implementation of their compliance programs, including audits, through the NERC Regional Operations Group; and (iv) amend the delegation agreements and the NERC Rules of Procedure as appropriate to accommodate and support the proposed changes to ensure consistent implementation of the CMEP processes across Regional Entities.⁸⁹

117. Other specific actions NERC intends to take in response to stakeholder and Regional Entity comments in order to improve the audit process include: (i) continue to review compliance violation results and event analyses to select Reliability Standards and requirements for active monitoring to focus attention on those areas where reliability could be most improved; (ii) consider splitting the three-year or six-year audits into a series of audits that cover fewer Reliability Standards in each audit but that in the aggregate will cover all the required Reliability Standards within the three- or six-year audit cycle; (iii) identify areas for improvement in audit processes and training auditors by soliciting feedback and consider the information gained and observations from NERC personnel participation in compliance audits conducted by each Regional Entity; and (iv) consider revising the audit process (as specified in the uniform CMEP, Appendix 4C to the NERC Rules of Procedure) to provide registered entities more time prior to audits to complete Reliability Standard Audit Worksheets.⁹⁰

Commission Conclusion

118. The Commission strongly supports NERC's efforts to address the uniformity concerns raised by commenters and encourages NERC to continue making improvements in consistency, particularly in the areas of compliance, reporting efficiency, and improved data gathering.⁹¹ With respect to comments regarding audit techniques and practices, we

⁸⁹ Performance Assessment, App. A at 8.

⁹⁰ Performance Assessment, Att. 2 at 28-29.

⁹¹ On June 9, 2010, NERC submitted a petition for the approval of a revised *pro forma* delegation agreement, eight delegation agreements with the Regional Entities and related revisions to the NERC Rules of Procedure. NERC's petition addresses certain action items identified in the three-year assessment with regard to compliance, including concerns regarding uniformity and consistency, and other action items discussed below.

(continued...)

note that while it is understandable that compliance auditors sometimes seek additional information during compliance audits, compliance auditors should prepare prior to on-site visits by reviewing fully information prepared by registered entities in response to pre-audit requests for information. Compliance auditors should consider the time and effort registered entities need to provide supplemental information when formulating on-site information requests and should identify the specific Standard requirements for which additional compliance information is sought. We suggest that NERC and Regional Entities consider providing ongoing training for their compliance auditors on effective auditing techniques. We expect that NERC's establishment of a Regional Operations Group that focuses on auditors will rapidly improve audit consistency and performance.

ii. Focus Audits on Actual Performance

119. Stakeholders commented that compliance audits currently focus too much on documentation and literal interpretations of and compliance with the requirements of the Reliability Standards, and do not provide the opportunity for a registered entity to explain what it did to comply, or to focus on the impact of the registered entity's actions on Bulk-Power System reliability.⁹² Stakeholders more specifically commented that the NERC and Regional Entity compliance programs, and compliance auditors, focus unduly on documentation and the wording of documentation, literal application of Reliability Standards requirements and the Reliability Standard Audit Worksheets rather than on actual performance that enhances Bulk-Power System reliability. According to commenters, compliance auditors sometimes are unwilling to objectively examine the registered entity's evidence or consider alternative demonstrations of compliance, including declining to allow registered entities to point out items that demonstrate compliance or explain their interpretation of the Reliability Standard or rationale for why they believe they were in compliance.

120. NERC states that, in response to stakeholders' concerns, it will focus audits on whether the registered entity's actual performance demonstrates compliance rather than on documentation. NERC also states that it will revise the Reliability Standard Audit Worksheets to improve their quality and usefulness and will continue to review compliance audit processes and post-audit questionnaires to verify that audit teams provided registered entities with an adequate opportunity to explain and demonstrate compliance with the applicable requirements.

This matter is pending before the Commission in Docket No. RR10-11-000.

⁹² Performance Assessment, Att. 2 at 25.

Commission Conclusion

121. The Commission agrees that the Reliability Standard Audit Worksheets should serve as no more than guidance to the auditor and the audited entity and that, for at least some Reliability Standards, there may be more than one way to demonstrate compliance. Therefore, the Commission supports NERC's efforts and encourages NERC to continually review its Reliability Standard Audit Worksheets to improve their quality and usefulness. The Commission notes that NERC recognizes that providing the types of evidence listed in Reliability Standard Audit Worksheets is not the exclusive way for registered entities to show compliance; rather, Reliability Standard Audit Worksheets are a tool for evaluating compliance. Nevertheless, a registered entity will become subject to the CMEP process if it is unable to demonstrate compliance.

iii. Participation in Regional Entity Compliance Audits by NERC Staff and Commission Staff

122. In some instances, NERC staff has participated in Regional Entity-led compliance audits. NERC indicates that its staff will continue to do so in order to observe the Regional Entities' performance of audits and to help ensure consistent implementation and application of the CMEP and consistent application of the Reliability Standards' requirements across the Regional Entities.

123. The Regional Entities state that NERC's and Commission staff's occasional participation as observers in Regional Entity audits has led to some confusion among the various audit participants regarding their respective responsibilities. In some cases, the NERC and Commission staffs have engaged in the audit process, and their inquiries exceeded those the Regional Entity staff would have asked; in other cases, NERC and Commission staffs simply are observers. The Regional Entities recommend that NERC set expectations and convey them through procedures or training, and selectively audit results to determine whether outcomes are within the guidelines.⁹³

Commission Conclusion

124. In Order No. 672, the Commission set out the role of a Regional Entity in relationship to the ERO. The Commission concluded that the ERO holds the primary responsibility for enforcement of Reliability Standards and that any delegation of this

⁹³ Performance Assessment, Att. 4 at 26.

responsibility to a Regional Entity is subject to ERO oversight.⁹⁴ NERC, as the ERO, is responsible for oversight to ensure quality and consistency among the Regional Entities.

125. While the Commission generally has left to NERC, as the ERO, how it should ensure quality and consistency among Regional Entities, the Commission has acknowledged “the need for rigorous enforcement audits of users, owners and operators of the Bulk-Power System by well-trained auditors applying consistent audit standards.”⁹⁵ Indeed, rigorous audits are a crucial element of ensuring the reliability of the Bulk-Power System.

126. The Commission commends NERC staff’s participation in, and observation of, Regional Entity audits. In order to ensure quality audits, the Commission believes that NERC must continue to staff observation audits with well-trained and knowledgeable auditors. Just as an auditor must have technical proficiency to conduct an audit rigorously, NERC staff, exercising oversight responsibility, must have technical proficiency to determine whether an audit is conducted with appropriate rigor. Moreover, the Commission finds that active involvement in audits is crucial to NERC’s oversight of them. NERC will not have carried out its mission if an event occurs because Regional Entity or NERC auditors did not sufficiently examine content. For these reasons, the Commission directs NERC to continue its oversight of Regional Entity audits with NERC staff that are technically proficient.

127. The Commission agrees with the Regional Entities’ comments that the audit process would be well served by better defining observers’ roles and functions. In its guidance order on ERO and Regional Entity compliance audits, the Commission provided specific guidance on the roles of NERC and Regional Entity staffs during NERC-led audits.⁹⁶ However, the Commission acknowledges that in compliance audits conducted by the Regional Entities, the observers’ roles have varied. In some instances, the Regional Entity may request that NERC or Commission staff actively participate and in other instances the Regional Entity may request less participation. However, depending upon how the audit is progressing, NERC and Commission observers may take a more active role in assuring a quality compliance audit. Therefore, the

⁹⁴ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 654.

⁹⁵ *Id.* P 463.

⁹⁶ *Compliance with Mandatory Reliability Standards*, 126 FERC ¶ 61,038, at P 5 (2009).

Commission directs the NERC and Regional Entities to have their staff, and Commission staff where applicable, discuss during their pre-audit meetings or conferences the appropriate role of observers.

b. Penalty Determinations

128. NERC is generally positive about its current procedures for determining penalties, but states that there is room for improvement in some areas. NERC acknowledges that stakeholders have concerns about the perceived lack of transparency in the basis for penalty determinations, and addresses those concerns.⁹⁷

129. Specifically, NERC acknowledges that the bases for NERC and Regional Entity penalty determinations for Reliability Standards violations should be more transparent to stakeholders, and more consistent and efficient in their application. Currently, with respect to a violation of a particular requirement of a Reliability Standard, NERC and the Regional Entities consider the Violation Risk Factor, the Violation Severity Level, when applicable, and the NERC Sanction Guidelines to identify an initial base penalty amount range for the violation. NERC also considers other factors, including the potential impact of the violation on the Bulk-Power System and other aggravating and/or mitigating factors, to reach a final penalty amount, either within the base penalty amount range, or, in some circumstances, outside of that range.⁹⁸

130. NERC proposes to address the expressed need for greater transparency in penalty determinations in two ways. First, NERC plans to conduct a policy-level review of the Sanction Guidelines and the penalty determination process.⁹⁹ Second, to improve the speed of processing alleged violations, NERC suggests implementation of an option for Regional Entities to request earlier NERC involvement to assist with the development of notices of alleged violation or of settlement offers to be proffered to registered entities.

131. NERC notes that its process for determining penalties emphasizes the importance of self-disclosure of violations and voluntary corrective actions by the violator, in part by treating them as mitigating adjustment factors that can reduce penalty determinations.¹⁰⁰

⁹⁷ Performance Assessment at 36, 38-39.

⁹⁸ *Id.*, Att. 1 at 27-32.

⁹⁹ *Id.*, App. A at 9.

¹⁰⁰ *Id.*, Att. 1 at 30.

NERC states that while self-reporting remains the most common means for identifying alleged violations, self-reporting has trended downward from the inception of the mandatory Reliability Standards as registered entities further develop their compliance programs.¹⁰¹ NERC reports stakeholders' comments that NERC and Regional Entities have not effectively encouraged self-reporting because, the stakeholders complain, self-reports are not processed faster than alleged violations detected by other means, the administrative process is burdensome even for self-reported violation, and there is no indication that self-reporting results in any reduction of penalties.¹⁰²

132. NERC acknowledges stakeholder concerns that there is no incentive for registered entities to self-report violations because there is no apparent advantage or benefit to self-reporting. NERC points out that for violations of a minor or administrative nature, self-reported and self-certified violations should result in shorter processing times because it is easier to develop a record on these violations. Noting that penalty determinations are necessarily based on the specific facts of each violation, NERC contends that it is impractical and inappropriate to indicate a specific dollar amount of credit for self-reporting or any other mitigating factor. However, NERC observes that its notices of penalty specifically state when self-reporting has been a factor taken into account in mitigating a penalty.¹⁰³ NERC further responds to stakeholder concerns by committing to incentivize self-reporting with a two-pronged approach. First, NERC will continue to offer the *pro forma* settlement approach, in a revised form, for self-reported violations of a minor or administrative nature.¹⁰⁴ Second, NERC plans to evaluate enforcement actions to determine the overall impact of self-reporting, and will report its findings to stakeholders.

Commission Conclusion

133. We agree with NERC that there always will be some tension between the transparency of specific NERC Sanction Guidelines and flexibility to negotiate penalties in specific cases. The Commission believes that NERC and the Regional Entities must retain flexibility in determining the specific penalties appropriate for individual cases,

¹⁰¹ *Id.* at 63.

¹⁰² *Id.*, Att. 2 at 24.

¹⁰³ *Id.* at 25.

¹⁰⁴ *Id.*, App. A at 8.

particularly in the context of achieving settlements. Penalties also should not be so rigid or predictable that a registered entity would feel comfortable in calculating a penalty as the cost of doing business.¹⁰⁵ Registered entities should understand the seriousness of violating a Reliability Standard. We believe that the NERC Sanction Guidelines currently in place generally allow NERC and the Regional Entities to balance these priorities. However, if in the future NERC believes that amended NERC Sanction Guidelines would better serve compliance and enforcement goals to provide more transparency and predictability in penalty determinations, it may file such a proposal for our approval.

134. Self-reporting also is an important part of the compliance process. Self-reporting allows registered entities to identify potential violations and pro-actively report those potential violations. The self-reporting process could save resources and may be used as a means to expedite corrective action if, and even before, the Regional Entity confirms that a violation occurred. For these reasons, the Commission agrees that NERC should continue to encourage, and develop incentives for, registered entities to self-report potential violations to the Regional Entities. It is entirely appropriate for NERC and Regional Entities to provide this incentive by decreasing penalties when effective self-reports have occurred consistent with our Policy Statement on Compliance.¹⁰⁶ The Commission also notes that the speed with which NERC and the Regional Entities process a self-report does not always reflect the level of encouragement for the practice. A self-reported violation may contain complicated facts that require NERC or the Regional Entity to spend considerable time reviewing the circumstances surrounding the violation as well as the mitigation plan to correct it.

c. **Delegation Agreements**

NERC Performance Assessment

135. NERC states that it established a single set of rules for the organization registration program and another set of rules for the certification and compliance

¹⁰⁵ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 455.

¹⁰⁶ *Compliance with Statutes, Regulations, and Orders*, 125 FERC ¶ 61,058 (2008). However, we remind NERC that required notifications of compliance-related issues are not self-reports, and do not warrant a “self-reporting” reduction in penalty amounts. *See Guidance Order on Reliability Notices of Penalty*, 124 FERC ¶ 61,015, at P 32 (2008).

monitoring and enforcement programs. Regional Entities must identify any regional exception to those rules in their delegation agreements and they must be approved by NERC and the Commission. However, stakeholders contend that implementation of these rules has been different across the Regional Entities due to a lack of clarity in the delegation agreements, combined with legacy issues surrounding the familiarity of Bulk-Power System owners, operators, and users with the existing programs.

136. NERC also explains that it and the Regional Entities need to amend the delegation agreements to implement performance metrics on compliance, require consistent implementation across all Regional Entities, and include a more rigorous decision-making process for matters that NERC and the Regional Entities need to resolve on a consistent basis.

137. NERC states that it has not set or enforced mandatory performance metrics for, or required identical implementation of, the Regional Entity compliance programs.¹⁰⁷ NERC contends that delegating compliance enforcement to Regional Entities has created value by encompassing local knowledge of the Bulk-Power System and providing a substantial source of resources. However, to achieve the level of consistent, transparent, efficient, and timely performance stakeholders are expecting, NERC recommends amending the delegation agreements to provide specific performance metrics and require consistent implementation across all Regional Entities. In their Joint Regional Entity Self-Assessment, the Regional Entities agree, and state that: “In order to successfully implement a decentralized model over the long term and truly leverage the existing infrastructure, resources, and knowledge in the Regional Entities, NERC should establish and clearly communicate systems, procedures and processes, performance metrics and controls, and training.”¹⁰⁸

Commission Conclusion

138. The Commission commends NERC and the Regional Entities on their efforts to resolve delegation issues. We agree that NERC should develop performance metrics that help to ensure consistent implementation of the compliance enforcement process across

¹⁰⁷ Performance Assessment at 38.

¹⁰⁸ *Id.*, Att. 4 at 16.

the regions. Further, the Commission supports development of a more rigorous decision-making process for the consistent and timely resolution of matters by NERC and the Regional Entities.¹⁰⁹

d. No-Action Letter Proposal

NERC Performance Assessment

139. NERC proposes a no-action letter advisory process as a potential way of providing additional guidance to registered entities. NERC provided a broad outline of what form the process might take, stating that the proposed letters would be issued by either NERC or the Regional Entities and could include templates, examples or case histories of acceptable practices and documentation.¹¹⁰ NERC is considering reviewing proposed future actions for Reliability Standards compliance through “a process or processes by which registered entities can submit hypothetical or proposed means of complying.”¹¹¹

Comments

140. EPSA supports NERC’s plan to establish an additional guidance process, similar to the Commission’s no-action letter process, to facilitate communication between compliance and enforcement staff and registered entities. EPSA recognizes NERC’s concern regarding resources, but believes such a process ultimately would reduce burdens on NERC and Regional Entities by reducing inefficient, case-by-case communications. Likewise, EEI comments on the need to provide more information and guidance to registered entities concerning the compliance and enforcement process, including guidance on “what it takes to comply with and demonstrate compliance with Reliability Standards.”¹¹²

¹⁰⁹ These matters also are addressed in NERC’s June 2010 petition for approval of revised delegation agreements pending before the Commission in Docket No. RR10-11-000.

¹¹⁰ Performance Assessment at 39; Att. 2 at 20-21.

¹¹¹ *Id.*, Appendix A at 7.

¹¹² EEI Comments at 5.

Commission Conclusion

141. If NERC continues to believe a no-action process would be helpful, it should submit to the Commission a proposal to amend its rules of procedure to implement such a process. Any NERC no-action letter process should be similar to the Commission's no-action letter process so that the NERC process: (1) would determine whether a specific set of facts that a requestor provides regarding an actual (i.e., not hypothetical) situation would be in compliance with the Reliability Standards; (2) does not address past behavior, i.e., is not applicable retroactively; and (3) is not binding on the Commission. Similarly, no-action letters, while addressing the views of NERC staff as to whether enforcement action would be taken, should not be binding on NERC.

142. The more specificity provided in a no-action letter request, the better NERC can evaluate the request and the more useful the guidance will be to the requestor and the industry. A hypothetical submission cannot have the necessary facts and details to allow NERC to successfully evaluate a situation and make an informed analysis and conclusion. For this reason, the Commission has rejected the inclusion of hypothetical or anonymous requests from the inception of its own no-action letter process.¹¹³ Avoiding no-action letter determinations based on hypothetical situations also reduces the chance that registered entities will use the guidance provided in ways that NERC did not intend, as each determination will be grounded on specific factual situations.

143. The Commission further believes that if NERC decides to propose a no-action letter process, only NERC, not the Regional Entities, should have the authority to issue no-action letter determinations. This limitation would ensure consistency of no-action letter determinations throughout all of the regions, thereby providing more helpful guidance and certainty to registered entities.

144. Any no-action letter process proposed by NERC must also address the following matters: (1) the relationship between the no-action letter process and the current process by which registered entities may submit to NERC requests for formal Standards interpretations, which then must be submitted for Commission review and approval before they become effective; (2) how no-action letter requests and determinations would

¹¹³ *Informal Staff Advice on Regulatory Requirements*, 113 FERC ¶ 61,174, at P 10 (2005) (“[O]ur no-action letter process is intended to assist regulated entities in seeking guidance on the real world application of our regulations and orders. To accomplish this objective, requestors must provide sufficient detail for staff adequately to address the factual and legal issues presented in the request.”).

be publicized so as to provide guidance to all the Regional Entities and registered entities; (3) the process to be used in the event of a conflict between a no-action letter and the Commission's interpretation of a requirement; and (4) whether NERC would have adequate resources to implement a no-action letter process without sacrificing the resources needed for the optimum performance of its current duties.

3. Critical Infrastructure Protection

145. In Order No. 706, the Commission approved eight critical infrastructure protection (CIP) Reliability Standards.¹¹⁴ Further, pursuant to section 215(d)(5) of the FPA, the Commission directed NERC to develop modifications to the CIP Reliability Standards to address specific matters identified by the Commission. In addition, the Commission urged NERC to monitor the development and implementation of National Institute of Standards and Technology (NIST) standards related to cyber security and stated that "any provisions that will better protect the Bulk-Power System should be addressed in NERC's Reliability Standards development process."¹¹⁵ In response to Order No. 706, NERC is developing modifications to the CIP Reliability Standards in a multi-phase project. NERC has submitted "version 2" and "version 3" CIP Reliability Standards, which the Commission has approved.¹¹⁶ NERC plans to submit further modifications to complete the phased project.

¹¹⁴ *Mandatory Reliability Standards for Critical Infrastructure Protection*, Order No. 706, 122 FERC ¶ 61,040, *order on reh'g*, Order No. 706-A, 123 FERC ¶ 61,174 (2008), *order on clarification*, Order No. 706-B, 126 FERC ¶ 61,229 (2009), *Order denying clarification*, Order No. 706-C, 127 FERC ¶ 61,273 (2009).

¹¹⁵ Order No. 706, 122 FERC ¶ 61,040 at P 233.

¹¹⁶ *North American Electric Reliability Corp.*, 128 FERC ¶ 61,291, *order denying reh'g and granting clarification*, 129 FERC ¶ 61,236 (2009) (approving "version 2" CIP Reliability Standards); *North American Electric Reliability Corp.*, 130 FERC ¶ 61,271 (2010) (approving "version 3" standards).

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146. NERC's critical infrastructure protection activities include the development of CIP Reliability Standards and related guidance, the implementation of a CIP compliance and enforcement program, an alert system, and coordination with federal authorities.¹¹⁷

147. As mentioned above, NERC plans to complete modifications to the CIP Reliability Standards in a multi-phase project. In the Performance Assessment, NERC states that this effort includes a thorough evaluation of the NIST cyber security framework to identify improvements to protecting critical assets on the grid. Specifically, NERC states that it will consider relevant features of the NIST cyber security standard framework described in NIST Special Publication 800-53, as well as the identification of what cyber equipment the CIP Reliability Standards should address.¹¹⁸

148. In addition to NERC's efforts to develop modifications to the CIP Reliability Standards, NERC identifies several action items to improve NERC's critical infrastructure protection program. NERC states that, in response to stakeholder comments, NERC will centralize CIP implementation at NERC in part to avoid inconsistent approaches among Regional Entities. This effort will include training for NERC and Regional Entity auditors on CIP fundamentals and developing educational material for industry participants. Further, NERC will develop a risk assessment program that provides a formal plan to receive infrastructure protection concerns from government organizations and assemble a landscape of physical and cyber security risks to the Bulk-Power System by assessing threats and hazards.

149. NERC states that stakeholders commented on the need for more timely guidance on implementation of CIP Reliability Standards, particularly for the identification of critical cyber assets using a risk-based methodology (as set forth in Reliability Standard CIP-002). NERC states that, in response, it is taking "aggressive efforts and providing specialized support" to the drafting team tasked with modifying the CIP Reliability Standards. Additionally, NERC intends to work with its stakeholder Critical Infrastructure Protection Committee to finalize the development and issuance of guidelines on the implementation of CIP Reliability Standards, particularly about the identification of Critical Assets and Critical Cyber Assets using risk-based

¹¹⁷ Performance Assessment, Att. 1 at 113; Att. 2 at 47-50.

¹¹⁸ Performance Assessment, App. A, at 14.

methodologies. NERC states that these guidelines are posted as reference documents associated with CIP Standards.

150. As another means to provide timely guidance, NERC proposes as an action item to implement a “fast-track” process for responding to requests for interpretation of the CIP Reliability Standards. NERC states that this process would not require implementation of the full existing Reliability Standards development process, and could improve efficiency without sacrificing quality. NERC also will consider the feasibility of a hotline or other assistance function to address CIP implementation questions.

Commission Conclusion

151. We appreciate NERC’s efforts regarding critical infrastructure protection. We recognize NERC’s efforts to respond to the Commission’s directives in Order No. 706 by revising and modifying the CIP Standards, including NERC’s efforts to consider the NIST framework. In addition to the NIST framework, NERC may choose to incorporate other relevant approaches in accomplishing the revisions to the CIP Standards. For instance, NERC also should examine the Department of Homeland Security Catalog of Control System Security, which currently is being examined by the NIST-led Smart Grid Interoperability Panel – Cyber Security Working Group for security requirements that may be applicable to the various smart grid applications. The Catalog incorporates much of the NIST Federal Information Security Management Act framework and expands on it.

152. We agree with NERC on the need to provide timely guidance regarding the identification of cyber assets. Accurate, complete and consistent identification of the cyber assets that require protection across all registered entities is vital to the effectiveness of all the CIP Reliability Standards. We note that NERC has completed some guidance documents.¹¹⁹ However, we remind NERC that the Commission directed it in Order No. 706, when approving Reliability Standard CIP-002-1, which pertains to

¹¹⁹ Version 1 of NERC’s “Security Guideline for the Electric Sector: Identifying Critical Assets” received final approval from the NERC’s Critical Infrastructure Protection Committee (CIPC) in September 2009. NERC’s “Security Guideline for the Electric Sector: Identifying Critical Cyber Assets” was approved by CIPC and became effective on June 17, 2010 and is posted on NERC’s website as a reference document for Reliability Standard CIP-002. NERC continues to develop other CIP Security Guidelines addressing Communications, Emergency Preparedness, Vulnerability and Risk Assessment, Time Stamping of Informational Logs, Information Protection, and Employment Background Screening.

critical cyber asset identification, to provide structure and sufficient oversight¹²⁰ and guidelines to allow registered entities to determine accurately that an asset is critical to the Bulk-Power System. We encourage NERC to intensify its efforts to provide additional oversight and guidelines to assist registered entities in accurately determining that an asset is critical to the Bulk-Power System.

153. NERC states that centralization of CIP implementation at NERC will help to avoid inconsistent approaches among Regional Entities. We support this action item and, in that context, believe NERC should ensure that there is quality, uniformity and consistency amongst the Regional Entities when conducting compliance audits and spot checks relating to CIP Reliability Standards. We also support NERC's action items pertaining to educating NERC auditors regarding critical infrastructure protection. CIP audits must be led and staffed by qualified audit team members. To maintain the essential knowledge and skills to conduct cyber security audits, NERC should consider the worthiness of an ongoing "accreditation" of qualified auditor candidates through continued education. A program that establishes the requisite level of knowledge and skills needed to maintain necessary levels of technical expertise on a continuous basis should be the goal of the CIP audit program. These qualifications should be designed to verify the knowledge and skills of the auditor in the area of CIP, control systems and information technology. Cyber threats continue to evolve and increase in complexity; therefore, it is important for auditors to receive frequent and comprehensive training so that their skills and knowledge are current and up to date.

154. NERC's proposed action item for "fast-track" interpretations lacks specificity. NERC states that this process would not require implementation of the full existing Reliability Standards development process, and could improve efficiency without sacrificing quality, but otherwise NERC does not provide any details how it would implement this proposal. While we support efforts to provide greater guidance on CIP implementation, we are concerned whether "fast track" interpretations will provide the consistency, clarity and transparency for meaningful assistance to entities that must comply with the CIP Standards. If NERC develops this proposal, NERC should submit it to the Commission for review, possibly in the form of a petition for approval of modifications to NERC's Rules of Procedures, which currently provide procedures for

¹²⁰ In accordance with Order No. 706, P 329, this oversight should include "a process of external review and approval of critical asset lists based on a regional perspective."

interpretation of Reliability Standards.¹²¹ Further, all interpretations require Commission approval before they become effective and can be appended to a Reliability Standard.

4. Compliance Registry

NERC Performance Assessment

155. NERC explains that to begin monitoring and enforcing compliance with the mandatory Reliability Standards, it was necessary for NERC and the Regional Entities to identify and register the owners, operators, and users of the Bulk-Power System that perform reliability functions and whose operations are important to reliability. To accomplish this task, NERC: (i) identified the different reliability functions performed by owners, operators, and users of the Bulk-Power System using the Reliability Functional Model¹²² categories that are embodied in NERC's Reliability Standards; (ii) developed NERC's *Statement of Compliance Registry Criteria* (Registry Criteria) to define attributes that place an owner, operator, or user within a reliability functional category; and (iii) through the Regional Entities, identified the users, owners, and operators who perform these reliability functions and registered them, by function, on the NERC and Regional Entity Compliance Registries.¹²³

156. NERC states that over 1,800 entities that own, operate, or use portions of the Bulk-Power System are registered, by reliability function, on the NERC Compliance Registry. NERC explains that each registered entity knows its reliability functions under the Functional Model and, therefore, the Reliability Standards with which it is responsible to comply.

¹²¹ See NERC Rules of Procedure, App. 3A, Reliability Standards Development Procedure, at 30 (effective Feb. 5, 2010).

¹²² NERC's Reliability Functional Model provides the foundation and framework upon which NERC develops and maintains reliability standards. The Functional Model defines the set of functions that must be performed to ensure Bulk-Power System reliability and explains the relationship between and among entities for performing tasks within each function. More information about the Functional Model is *available at*: <http://www.nerc.com/page.php?cid=2|247|108>.

¹²³ Performance Assessment at 26.

157. In response to stakeholder input, NERC identified the following action items pertaining to the Compliance Registration program: (1) consider raising the threshold criteria for requiring entities to be registered; (2) improving consistency across Regional Entities; (3) providing a single registration for entities doing business in more than one region; and (4) improving joint registration procedures. In addition, NERC states that stakeholders recommended that NERC modify the registration requirements to allow entities to register for packages of requirements that correspond to their activities rather than be responsible for all requirements applicable to a functional category for which they are registered. NERC does not support this ‘registration by requirement’ approach, explaining that the proposal would be cumbersome, whereas the current program allows NERC to judge which requirements apply on a case-by-case basis. NERC posits that, in situations where certain requirements of a Reliability Standard would not apply to a particular entity based on its business structure, the use of a joint registration agreement is more appropriate.

158. While NERC proposes to consider raising the threshold criteria, it also states that the registration process is working well and thus this is a low priority. NERC explains that it reviews the registration categories and criteria on an ongoing basis and makes changes when deemed necessary and that, in fact, NERC has revised the Registry Criteria several times. NERC also notes that registered entities have been removed from the Compliance Registry, citing to a review conducted by FRCC and NERC in 2009 that resulted in the removal of smaller generators from the registry. Specific action items would include: (1) reviewing existing registration criteria with NERC technical staff for possible changes; (2) reviewing data from surveys of registered entities; (3) supporting Regional Entities working through existing procedures and continuing to respond to specific issues related to registration criteria on a case-by-case basis; and (4) reinforcing to Regional Entities that they can remove entities from the Compliance Registry, but that the Regional Entity must determine that removal of the entity creates no material impact to Bulk-Power System reliability before the entity is removed from the Compliance Registry.

Comments

159. EPSA emphasizes that NERC and the Regional Entities should engage in a collaborative effort to assure consistency as to registration decisions. EPSA asks the Commission to support NERC’s specific action item to implement recommendations by “the Ad Hoc Group for Generator Requirements at the Transmission Interface ... [which

is] scheduled to complete its work by the end of 2009.”¹²⁴ EPSA states that it supports the Ad Hoc Group’s recommendation that NERC and the Regional Entities refrain from further registering generator owners and generator operators as transmission owners and transmission operators by virtue of their generation connection facilities.

Commission Conclusion

160. We commend NERC and the Regional Entities on their efforts to identify and register over 1,800 users, owners and operators of the Bulk-Power System during the last three years. We generally support NERC’s action items, and also agree with NERC that there is no compelling need at this time to significantly change the current registration program to implement “registration by requirement.”¹²⁵

161. We are sympathetic to EPSA’s general concern for consistency in registration decisions. However, we cannot at this time endorse NERC’s specific action item regarding the recommendations of the Ad Hoc Group. First, based on the record before us, it appears that the group’s specific recommendations were not presented to NERC at the time the action item was approved. Second, under certain circumstances, it may be appropriate to register a generator owner that owns a tie line and interconnection facilities as a transmission owner and transmission operator.¹²⁶ Thus, we will defer consideration of this item until NERC presents us with a specific proposal.

162. While NERC indicates that it will consider whether to raise the thresholds set forth in the Registry Criteria, NERC also observes that the registration process is working well

¹²⁴ EPSA Comments at 9-10. *See* Performance Assessment, App. A at 5.

¹²⁵ In a similar vein, NRECA advocates that NERC increase the “granularity” of the applicability section of all existing and future Reliability Standards. According to NRECA, this granularity would allow for the fact that an entity may, e.g., be a distribution provider for one Reliability Standard but not another. EPSA notes that NERC’s Rules of Procedure allows such granularity, which provides that the applicability section of each Reliability Standard must identify the functional classes of entities responsible for complying, with any additions or exceptions noted. NERC Rules of Procedure, § 304. While such granularity may be appropriate in specific cases, we do not endorse EPSA’s proposal to increase the granularity of the applicability provision of every current and future Reliability Standard.

¹²⁶ *See New Harquahala Generating Co., LLC*, 123 FERC ¶ 61,173 (2008).

and will treat this item as a low priority. NERC has the discretion to consider this matter; however, the Commission has adopted the registry criteria and any proposed revisions to the thresholds must be submitted to the Commission for approval.¹²⁷ While we understand that a change in the thresholds for registration could help relieve the burden on small and medium-sized entities, that consideration alone is not sufficient justification for a modification to the Registry Criteria. Rather, any such filing must justify the need for the revisions from a reliability point of view and analyze the impact of the proposed revisions to the threshold criteria on Bulk-Power System reliability.

5. Situational Awareness, Event Analysis, Reliability Assessment and Performance Metrics

163. NERC, in the Performance Assessment, also provides an assessment regarding the effectiveness of its various functions and activities related to conducting periodic reliability assessments, situational awareness, event analysis and reliability benchmarking. The Commission is generally in agreement with NERC's analysis and is supportive of NERC's proposed action items regarding these topics, except as noted otherwise below.

a. Situational Awareness

164. NERC states that its application to become the ERO included a provision to provide situational awareness for the bulk power interconnections in North America.¹²⁸ NERC explains that its Situational Awareness for FERC, NERC, and the Regions (SAFNR) project,¹²⁹ provides displays of near real-time Bulk-Power System conditions to NERC, FERC, and the Regional Entities. Completion of the SAFNR project will enable FERC, NERC, and the Regional Entities to obtain near real-time information directly from the reliability coordinators without interfering with the reliability coordinators' activities.

¹²⁷ See Order No. 693, FERC Stats. & Regs. ¶ 31,242 at P 94-96.

¹²⁸ Performance Assessment, Att. 2 at 52.

¹²⁹ The SAFNR project is intended to display to the Commission, NERC, and the regions, through a secure internet access system, the conditions of all of the reliability coordinators within the United States.

165. NERC states that stakeholders are concerned that real-time situational awareness is duplicative of the reliability coordinators' activities, adds expense, may actually interfere with system reliability, and is not helpful or appropriate.

Commission Conclusion

166. While stakeholders expressed concerns to NERC about the SAFNR project, we have no specific information to support their arguments against the project, and thus find no basis to require NERC to alter its plans on situational awareness.

b. Event Analysis

i. Improvements to Event Analysis

167. NERC reports that it has developed many tools and processes to enable event analysis, including: (1) a process for triage of system events reported to the Electric Sector Information Sharing and Analysis Center (ES-ISAC)¹³⁰ to determine the level of analysis necessary; and (2) the NERC Event Analysis Tool to aid in the event triage process and centrally gather preliminary information on system events.¹³¹

168. NERC states that it has made organizational improvements and hired staff to enable it to more quickly triage events, deploy resources to complete system studies, and issue industry alerts. However, stakeholders have expressed concerns that NERC is conducting event analyses for too many Bulk-Power System occurrences, i.e., for occurrences that are not significant enough to warrant an event analysis. According to stakeholders, event analyses take too long to complete, resulting in untimely dissemination of root-cause and lessons-learned information. NERC responds that if it analyzes only catastrophic events, it will miss opportunities to further improve reliability by lessons learned from less serious events.

¹³⁰ The ES-ISAC serves the electricity sector by facilitating communications between electricity sector participants, federal governments, and other critical infrastructures. The NERC Chief Security Officer is responsible for both objectives and has consolidated both functions under the ES-ISAC. Performance Assessment, Attachment 1 at 106-107.

¹³¹ Performance Assessment, Att. 1 at 96.

Commission Conclusion

169. The Commission agrees that NERC cannot timely and effectively analyze every event that occurs and, therefore, must select a subset of events to analyze fully. Some may be too minor; others may be similar to previous events, making study potentially of little benefit. Accordingly, the Commission directs NERC to establish criteria it will use to select this subset of events, which should focus on those with the highest impact to reliability, to provide important “lessons learned” and to submit this criteria in the informational report directed in this order.¹³²

170. In addition, the Commission’s staff needs timely access to detailed event information. Absent such information, the Commission’s identification of any needed improvements in the Reliability Standards could be delayed significantly. The Commission directs NERC to work with the Regional Entities to ensure that they provide to Commission staff, in accordance with the Reliability Standards and upon request, sufficient and timely information on each event, such as a sequence of events, one-line diagrams, and other reports at the time and in the condition it is received by NERC. NERC must report on steps it will take to implement this directive in the informational report following the issuance of this order.

171. The Commission also directs NERC to develop communication protocols between NERC, the Commission and the Regional Entities for use during events. These protocols will help avoid possible delays and miscommunications involved in establishing ad hoc procedures on a case-by-case basis. These protocols shall, at a minimum, establish: (i) contact person(s), (ii) phone and e-mail addresses, (iii) a communication hierarchy, (iv) minimum information that will be made available, and (v) a communication time line to ensure that relevant information is provided to NERC and the Commission in a timely manner. NERC shall provide a written protocol that shall be followed for sharing of the detailed event information. We direct NERC to report on its progress in this regard in the six-month informational filing.

¹³² These criteria should consider the causes of blackouts identified in and the recommendations from the U.S.-Canada Power System Outage Task Force’s Final Report on the August 14, 2003 Blackout in the United States and Canada issued March 31, 2004. Final Report on the August 14, 2003 Blackout in the United States and Canada: Causes and Recommendations, U.S.-Canada Power System Outage Task Force, April 2004, *available at* <http://www.ferc.gov/industries/electric/indus-act/reliability.asp>.

ii. **Timing of and Interaction between Event Analysis and Compliance Violation Investigations**

172. In its filing, NERC states that stakeholders claim that the speed of completing and disseminating information from an event analysis is adversely impacted when a compliance violation investigation (CVI) is conducted in conjunction with or shortly after the event analysis. Stakeholders assert that the relationship between event analysis and compliance programs has contributed to delays in completing event analyses and the reluctance of entities to provide information. Going forward, NERC proposes to review and expand existing procedures to clarify the interface between event analyses and CVIs with the objective of preserving and promoting the open exchange of information during event analyses necessary for feedback to the industry for purposes of reliability improvement.

Commission Conclusion

173. We support NERC's proposal to clarify the interface between event analyses and compliance activities, including CVIs.¹³³ Each process provides important benefits for the industry and enhances reliability.

174. To address the stakeholders' concerns, the Commission offers the following guidance to NERC. If a CVI is initiated, an event analysis and the CVI (and/or a Commission staff-conducted investigation under 18 C.F.R. Part 1b) should be done concurrently, to save both time and resources. Because both processes rely on accurate data which may be lost if not immediately secured, it is imperative that each entity involved be required to retain all relevant data and, to the extent necessary, both an event analysis and a CVI begin as soon as possible.

175. While the facts and circumstances in both an event analysis and a CVI often are the same, the focus of each inquiry is different. A CVI addresses whether Reliability Standards have been violated, while an event analysis addresses how an event occurred so as to prevent its recurrence. As such, the results of an event analysis should not be

¹³³ The Commission intends that its guidance in this area will apply not only to event analyses, but also to root cause analyses and other types of analyses or inquiries that relate to incidents or disturbances but do not rise to the level of an event analysis. Nevertheless, in all cases, information that indicates possible compliance violations should be passed on to the ERO or Regional Entity compliance personnel for appropriate investigation.

employed in lieu of a CVI or used to prejudge possible issues relating to compliance during an event. Industry participants are allowed to participate in event analysis but not in CVIs, where they may lack objectivity. The same applies to interim guidance that NERC proposes to provide before an event analysis is concluded, i.e., the guidance itself cannot assess possible violations of Reliability Standards. Similarly, the ERO or Regional Entity cannot delegate its authority to the registered entity to perform a preliminary event analysis as the basis for deciding whether or not to pursue a CVI. ERO or Regional Entity staff must be actively involved in the event analysis in order to produce an unbiased analysis and framing of the potential compliance issues surrounding the event.

176. In order to create more efficiency in the event analysis and CVI processes, all event analysis materials obtained by the event analysis team, including requests for information and responses, should be sent, at the same time as issued or collected, to the compliance staff in each applicable Regional Entity and to NERC compliance staff. These materials, insofar as they relate to a U.S. registered entity, also should be available to Commission staff upon request.¹³⁴ In this manner, personnel conducting a CVI can access the data and information obtained during an event analysis so as to minimize duplicative requests. At the same time, the personnel conducting an event analysis can proceed with their analysis without being aware of the activities of any CVI team, protecting the confidentiality of those processes. Because the applicable Regional Entity would receive all event analysis material regardless of whether a CVI was occurring, event analysis personnel would not necessarily be aware of an ongoing CVI.

177. Further, any communication between an event analysis team and a corresponding CVI team generally should be one-way only: from the event analysis team to the CVI team. This one-way information sharing will avoid the possibility that industry volunteers could receive and possibly disclose confidential compliance information. An exception to this practice would be appropriate only for factual information collected by a CVI team that bears on an important industry advisory that the event analysis team would make (or recommend that NERC make) as part of an initial event analysis determination.

178. NERC shall report on the steps it has taken to clarify the interface between event analyses and compliance activities, including CVIs, in response to the Commission's

¹³⁴ Until agreements are reached, we have no right of access to compliance-related information about possible violations by a Canadian or Mexican registered entity, and their regulators are similarly limited as to U.S. registered entities. The Commission strongly supports development of such agreements.

guidance in the informational filing due six months after the issuance of this order. The Commission also takes notice of a reorganization of NERC's staff, effective February 1, 2010, under which "Operations and Engineering is responsible for event analysis and investigation...."¹³⁵ NERC has not submitted in this proceeding an explanation of how this change will affect its procedures for event analysis and compliance functions. Accordingly, we direct NERC to include, in its informational filing due six months after the issuance of this order, the procedures to be used within its Operations and Engineering function relating to the communication and exchange of event analysis and investigative information, and procedures under which the Operations and Engineering function will communicate event analysis and investigative information to the compliance staff of NERC or a Regional Entity, consistent with the Commission's guidance provided above.¹³⁶ Because the NERC staff investigators will now have added event analysis to their duties, this informational filing also should address whether current staffing levels are sufficient for the increased workload. To the extent they are not, NERC should include any necessary adjustments to its budget request to allow for the proper staffing size and mix.

c. Reliability Assessment

i. Assessment Reports

179. NERC prepares three reliability assessment reports each year: (1) a long-term reliability assessment, (2) an annual seasonal summer report, and (3) an annual seasonal winter report.¹³⁷ In addition, NERC conducted a Scenario Assessment to measure the impact of significant supply-side changes from the 2008 Long-Term Reliability Assessment reference case. For this scenario case, NERC asked each Regional Entity to assess accommodating a minimum of an additional 15 percent of total energy from new renewable resources, above the reference case values, with no more than five percent

¹³⁵ See North American Electric Reliability Corp., *NERC News* at 2, available at <http://www.nerc.com/fileUploads%5CFile%5Cnewsletters/NERCNews-2010-02.pdf>.

¹³⁶ Should the review and expansion of existing procedures require a change in a rule of procedure or other organizational rule or protocol of NERC or a Regional Entity, NERC must file those changes for Commission approval pursuant to section 39.10(a) of our regulations, 18 C.F.R. § 39.10(a) (2010).

¹³⁷ Performance Assessment, Att. 1 at 89.

made up from energy efficiency, or to propose another scenario case that significantly impacts supply mix, electricity purchases, or sales in the studied region.

Commission Conclusion

180. Scenario Assessments are a critical tool for addressing reliability considerations arising from various emerging issues, including faster renewable resource integration. In light of the lengthy time needed to develop most reliability standards, this “look ahead” can help ensure that any new or modified standards that may be needed are developed and implemented timely. Therefore, we direct NERC to continue developing scenario analysis in the long-term reliability assessments using the criteria noted above. We require NERC to update its reliability assessment protocols to establish a requirement for an annual scenario analysis and to file this update in the informational filing due six months from the date of this order.

ii. Assessment Process Improvement

181. In 2008, NERC established and began implementing a comprehensive Reliability Assessment Improvement Plan. The plan is aimed at enhancing NERC’s seasonal (summer/winter) and long-term reliability assessments. The final report, which the NERC Planning Committee approved in September 2008, creates a platform from which NERC, in concert with Regional Entities and industry volunteers, can increase the level of independence, granularity, transparency, and comprehensiveness of its reliability assessments.

Commission Conclusion

182. The Commission supports NERC’s implementation of its Reliability Assessment Improvement Plan. We recognize that the reliability assessment process has been significantly enhanced during the past three years, providing more: (i) transparency regarding process, methodology, assessments and information used; (ii) consistency of input information; and (iii) granularity. Consequently, the assessments have become more comprehensive and systematic. We support NERC’s effort to further improve the assessment processes, and especially to increase NERC’s independence in evaluating: (i) data received from industry; (ii) assumptions; and (iii) reliability assessment approaches.

183. The Commission understands that the current reliability assessment methodology that applies Reserve Margin index relies upon evaluating whether the total generating

system capacity is sufficient to supply the system annual peak load.¹³⁸ NERC has stated that “[c]oupled with probabilistic analysis, calculated planning Reserve Margins have been an industry standard used by planners for decades as a relative indication of adequacy.”¹³⁹ This approach is acceptable for systems that mainly have thermal base-load generation (coal, nuclear, and gas). However, as NERC has noted, it may not be adequate for systems that contain significant levels of variable, non-dispatchable resources such as wind, solar, and run-of-river hydro plants. With high levels of variable resources, the Reserve Margin Index may provide a false indication in that there may be system reliability issues before the index identifies such problems.¹⁴⁰ We direct NERC to develop a plan to address capacity and energy in its reliability assessment methodology and a timeline for executing the plan, and submit the plan and timeline as part of the 2011 Long-Term Reliability Assessment. We require NERC to file its preliminary plan and timeline in an informational filing six months from the date of this order.

iii. Assessment Data Collection and Validation

184. NERC explains that the data, information, and Regional assessments submitted by each Regional Entity for the seasonal and the Long-Term Reliability Assessment are updated periodically throughout the report drafting process to ensure that they are as current as possible. After NERC receives the data, NERC staff and the Reliability Assessment Subcommittee perform further review to ensure accuracy and consistency. To improve data validation, in 2009, NERC began a review of its internal data collection and validation processes to fortify its current data analysis system.

¹³⁸ Reserve Margin is generally considered by industry as the difference between the total available generating system capacity and the annual peak load, divided by the peak system load.

¹³⁹ See North American Electric Reliability Corp. *2009 Long-Term Reliability Assessment 2009-2018* at 37 (Oct. 2009), available at http://www.nerc.com/files/2009_LTRA.pdf.

¹⁴⁰ See *id.* at 38 (“As the Planning Reserve Margin is a capacity based metric, it does not provide an accurate assessment of performance in energy-limited systems, e.g., hydro capacity with limited water resources.”).

Commission Conclusion

185. The Commission supports NERC's actions with respect to data collection and validation. Also, we direct NERC to consider establishing permanent data bases that could be automatically populated with: (i) new transmission projects data from the Regional Entities,¹⁴¹ (ii) generation interconnection queue data, and (iii) other data relevant for reliability assessment. We require NERC to discuss the feasibility of this improvement, and to the extent databases covering this information already exist, discuss how to better utilize or integrate that information into the Reliability Assessments in the informational filing required six months after the issuance of this order.

6. Business Planning and Budgeting, Accounting and Financial Reporting and Assessment Processes

186. In Order No. 672, the Commission determined that the ERO must file with the Commission an application for approval of the annual NERC and Regional Entity business plans and budgets.¹⁴² The Commission required that the annual application include supporting materials such as organizational charts, line item budget expenses, proposed collection techniques, and sufficient detail to justify requested funding and budget expenditures.¹⁴³

NERC Performance Assessment

187. NERC states that developing and refining the annual business plans and budgets have allowed NERC and Regional Entity management to better examine their use of resources. For example, the annual business planning and budgeting process focuses management attention on the programs that are succeeding in meeting their purposes and objectives and those that are not. The process drives the managements of NERC and the Regional Entities to make important decisions as to what programs and initiatives require

¹⁴¹ See, e.g., WECC Project Portal, *available at* <http://www.wecc.biz/Planning/TransmissionExpansion/Transmission/Pages/default.aspx>.

¹⁴² See Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 197; 18 C.F.R. § 39.4(b) (2009).

¹⁴³ ERO Certification Order, 116 FERC ¶ 61,062 at P 202.

greater resources and attention to be effective, and what programs and initiatives may warrant reduced levels of resources.¹⁴⁴

188. NERC states that it has developed a system of NERC accounts and, working in cooperation with the Regional Entities, has developed processes and procedures by which the Regional Entities report, and NERC tracks, the Regional Entities' actual expenditures against their approved budgets. The Regional Entities also submit audited financial statements to NERC each year.

189. NERC sets forth action items to address stakeholder concerns regarding the budget process, including: (1) developing multi-year business plans for NERC, (2) reconsideration of the net energy for load (NEL) cost allocation methodology, (3) changing the timing of the budget process, (4) updating annually NERC and the Regional Entities' three-year goals, (5) considering a "shared reserve" among Regional Entities and NERC, and (6) adopting uniform budget metrics.

190. NERC states that stakeholders commented that NERC should consider a cost allocation based on a combination of net generation, NEL and transmission kV miles. NERC explains that this approach would result in generators and transmission-only entities paying for ERO costs as well as load-serving entities.¹⁴⁵ NERC notes that section 215(c)(2)(B) of the FPA requires the ERO to have rules that allocate equitably reasonable dues, fees and other charges among end users. NERC states that the NEL methodology for cost allocation is reflected in NERC's Rules of Procedure and applied in NERC's annual budget. NERC explains that the value of the NEL is that it allocates the costs among all end-users, ensures that no one pays twice, and is relatively simple to administer. NERC further notes that it has entered into memoranda of understanding with several Canadian provinces that provide for allocation of costs of compliance programs on a basis other than NEL. In light of stakeholder comments, NERC proposes as an action item, "in conjunction with future annual business plans and budgets, review the rationale for continued use of NEL as the sole basis for allocating costs."¹⁴⁶

¹⁴⁴ Performance Assessment at 70.

¹⁴⁵ Performance Assessment, Att. 2 at 61.

¹⁴⁶ *Id.*, Att. 2 at 62.

Commission Conclusion

191. As mentioned above, the Commission finds that NERC continues to meet the certification criteria under section 39.4(b) with regard to rules for the equitable allocation of reasonable dues, fees and other charges among end-users. The Commission commends NERC's efforts in creating a Uniform System of Accounts to be utilized by NERC and the Regional Entities, as well as creating uniform performance metrics for budgeting purposes and creating a record retention policy in accordance with Commission directives. The Commission also commends NERC's willingness to identify underperforming program areas, and to modify program areas to use resources more efficiently over time.

192. However, the Commission remains concerned that NERC's annual budget process is not being used to effectively plan for and manage long term initiatives important in administering to the reliability of the Bulk-Power System. For instance, NERC revised its 2009 Business Plan and Budget in a December 15, 2008 filing after the Commission questioned the adequacy of NERC resources relating to its Standards Development and Compliance Monitoring and Enforcement programs to add an additional \$1,558,606 of expenditures for the 2009 fiscal year, taking these funds out of its Working Capital Reserve.¹⁴⁷ NERC subsequently explained that the long lead time necessary between commencing annual Business Plan and Budget preparation and the required August filing date with the Commission, and the additional time before the start of the budget year on January 1, can result in budgeted staffing and resource requirements and underlying assumptions being obsolete or in need of revision by the start of the budget year.¹⁴⁸ This explanation creates concern regarding NERC's and the Regional Entities' efforts to reduce or eliminate funding levels in their working capital reserve accounts.¹⁴⁹

193. The Commission recognizes the dual and opposing forces facing NERC and the Regional Entities in developing their annual budgets. On one hand, NERC and the Regional Entities are developing additional initiatives which will increase the reliability of the Bulk-Power System; on the other hand, there is notable pressure to keep annual

¹⁴⁷ NERC 2009 Budget Order, 125 FERC ¶ 61,056 at P 21.

¹⁴⁸ Performance Assessment, Att. 2 at 61.

¹⁴⁹ *See also* NERC 2010 Budget Order, 129 FERC ¶ 61,040 at P 24.

cost increases at reasonable levels.¹⁵⁰ One approach to dealing with these opposing forces has been to develop a flexible budget with a large operating reserve (working capital reserves); another has been to build a leaner budget and allow for supplemental filings to inject funding towards initiatives as needed. The Commission has conditionally accepted the latter approach in recent years, provided that NERC and the Regional Entities demonstrate their willingness to request additional funds when necessary.¹⁵¹ However, additional efforts where NERC and the Regional Entities engage in cooperative planning initiatives over multiple years may be beneficial to all parties.

194. Noting that NERC already engages in strategic planning out to five years, the Commission believes that joint strategic planning by NERC and the Regional Entities, under ERO oversight, may enhance the operations of the entire reliability apparatus and may decrease the tensions associated with the current NERC and Regional Entity budget process. While it may be difficult to establish precise numbers over multiple years, strategic planning coupled with a multiple year budget would put the Commission and stakeholders on notice regarding what to expect.

195. A joint strategic planning initiative also would address another major Commission concern, which is adequate monitoring of the Regional Entities' expenditures. The Commission notes that in NERC's compliance filing to the 2010 Business Plan and Budget, NERC acknowledged that it did not work with Regional Entities to roll up the actual number of compliance violation investigations for their 2010 estimate but rather relied on its own internal estimates to project the reasonableness of Regional Entity expenditures.¹⁵² In Order No. 672, the Commission found that the ERO must review and approve the Regional Entities budget expenditures, explaining that the ERO "must have oversight to ensure that Regional Entities are adequately funded to accomplish their

¹⁵⁰ North American Electric Reliability Corp. Request For Acceptance of its 2010 Business Plan and Budget and the 2010 Business Plans and Budgets of Regional Entities and For Approval of Proposed Assessments to Fund Budgets, Docket No. RR09-9-000, Att. 2 at 38; App. 1 to Att. 2 at 1 ("The current economic downturn continues into 2010, resulting in cost pressures on NERC and Regional Entities to do more with less") (filed Aug. 24, 2009).

¹⁵¹ NERC 2010 Budget Order, 129 FERC 61,040 at P 24.

¹⁵² North American Electric Reliability Corp., Compliance Filing of the North American Electric Reliability Corporation in Response to October 15, 2009 Order on 2010 Business Plans and Budgets, Docket No. RR09-9-001 at 8-12 (filed Dec. 11, 2009).

delegated functions.”¹⁵³ Thus, NERC is responsible for thoroughly investigating each Regional Entity budget and, where necessary, must suggest changes rather than presuming that the budget is reasonable. NERC must determine, at a minimum, whether each Regional Entity’s proposed budget is adequate to carry out the functions delegated to it. A joint NERC and Regional Entity strategic plan would assist NERC in this task because NERC would have greater access to the Regional Entities’ strategic plans and greater access to the actual planning numbers that the Regional Entities use to formulate their individual budgets. Accordingly, the Commission directs NERC to include in the six-month informational filing a report detailing the feasibility of establishing a NERC-led Strategic Planning initiative utilizing multiple year budgets.

196. As described above, NERC proposes to review the rationale for continued use of NEL as the sole basis for allocating costs. While NERC has the discretion to perform such a review, the Commission will closely scrutinize any proposal to revise the current cost allocation methodology. We agree with NERC that NEL is a reasonable and equitable methodology because it allocates the costs among all end-users, ensures that no one pays twice, and is relatively simple to administer. Based on this rationale, the Commission approved the NEL methodology in the ERO Certification Order, which has withstood appellate court scrutiny on this issue.¹⁵⁴ Any such proposal to revise NERC’s cost allocation methodology should justify any change from the existing approved method and demonstrate that the alternative methodology satisfies section 215(c)(2)(B) of the FPA.

C. Evaluation of Regional Entities

197. As discussed in Section A above, we find pursuant to section 39.3(c)(2) or our regulations that each Regional Entity meets the statutory and regulatory criteria for delegation of ERO authority to a Regional Entity. Below, we discuss several specific

¹⁵³ Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 227.

¹⁵⁴ ERO Certification Order, 116 FERC ¶ 61,062 at P 167. *See also North American Electric Reliability Corp.*, 122 FERC ¶ 61,245, at P 24-25 (2008) (stating that the Commission “continue[s] to believe that net energy for load provides a fair and reasonable means for allocating costs,” expressing concern that a NERC proposal to revise the *pro forma* delegation agreement “would be used to encourage local differences to a methodology that is currently applied across the regions,” and encouraging that future proposals to change the cost allocation formula be filed in advance of NERC’s annual budget filing to allow sufficient time for the Commission to consider the matter).

concerns regarding Regional Entity activities including: (1) compliance monitoring and enforcement issues concerning all Regional Entities; (2) NERC's evaluation of each Regional Entity compliance program; (3) SPP independence; and (4) WECC's voting structure.

1. Compliance Monitoring and Enforcement

a. Issues Concerning all Regional Entities

NERC Performance Assessment

198. NERC states that the Regional Entities' implementation of the uniform CMEP generally has been successful, although the Regional Entities can and should make a number of improvements. The Regional Entities have, according to NERC, established compliance monitoring programs that include all the compliance monitoring methods established in the NERC uniform CMEP, and conduct workshops to support the registered entities' understanding of the compliance requirements.¹⁵⁵

199. NERC notes that during the period prior to the Reliability Standards becoming mandatory and enforceable on June 18, 2007, registered entities reported over 5,100 separate Reliability Standard violations. NERC indicates that the Regional Entities and NERC itself successfully processed these self-reported violations and mitigation plans. According to NERC, the Regional Entities determined that over 1,800 of these reports did not involve actual violations, and the registered entities generally completed mitigation for the remaining 3,300 violations before the end of 2007.

200. Following June 18, 2007, when the Reliability Standards became mandatory and enforceable, through May 31, 2009, NERC received reports of 2,761 alleged Reliability Standard violations from the Regional Entities. The Regional Entities dismissed many of these potential violations after investigation and, as of May 31, 2009, were processing the remaining 1,926 alleged violations. As of that date, NERC indicates that the Regional Entities and NERC had accepted and approved mitigation plans for 1,367 of these alleged violations. However, the Regional Entities had provided only 475 violations as a notice of confirmed violation or settlement to NERC staff for review and approval by NERC's Board of Trustees Compliance Committee, which had approved only 219 of these as of May 31, 2009.

¹⁵⁵ Performance Assessment, Att. 3 at 9.

201. NERC identifies several issues regarding compliance monitoring and enforcement that apply to all the Regional Entities, and to NERC itself. NERC suggests a number of improvements the Regional Entities should make to their processing of alleged violations and mitigation plans, such as improving the speed of processing alleged violations and companion mitigation plans to completion. NERC states that the Regional Entities also should improve their processes related to conducting compliance violation investigations, including more thorough evidence gathering and review, investigation depth, and application of the Reliability Standards in specific situations. In addition, NERC suggests that the Regional Entities improve the thoroughness and accuracy of information provided to NERC for review in draft notices of penalty that NERC would file with the Commission.

202. NERC notes that stakeholders are concerned about consistency among the Regional Entities and the level of NERC oversight in maintaining consistency. According to NERC, stakeholders believe NERC needs to take a stronger leadership role in eliminating differences among Regional Entities and to ensure uniformity and consistency across the regions. Specifically, stakeholders are interested in consistency of process and consistency of results. NERC indicates that it and the Regional Entities will have an opportunity to address these concerns when they re-negotiate the delegation agreements between NERC and each Regional Entity, which expire in May of 2010.

203. NERC indicates that it and the Regional Entities are working toward developing a “centralized data hub” that can accommodate the existing compliance reporting and data management tools the Regional Entities utilize to ensure a seamless flow of data between NERC, the Regional Entities, registered entities and regulators. In a related vein, NERC notes that stakeholders would like better communication of lessons learned and other information regarding compliance, specifically application of the Reliability Standards to compliance evidence. NERC suggests development of a knowledge management platform that would hold such information in a fully searchable database, and notes that it is implementing a Question and Answer website to provide some key information, including consolidated information received from the Regional Entities. NERC also believes it and the Regional Entities need to develop a communications strategy regarding compliance issues that ensures that Regional Entity communications are coordinated for content and consistency with NERC’s objectives.

204. NERC raises several issues and proposes actions related to the overall volume of work and the outputs of the compliance program, including the backlog on processing alleged violations. NERC states that some method of prioritizing violation processing is necessary. NERC encourages the Regional Entities to pursue settlements that bundle a registered entity’s violations and similarly suggests using multi-region settlements for registered entities that cross several regions as a means to bundle violations for

administrative efficiency. NERC also indicates that processing documentation-related violations in the same way as violations that do not result from a lack of relevant documentation of compliance can result in a less efficient compliance program and slows average processing time due to the volume of documentation-related violations. NERC states that some parties have suggested that NERC should have discretion to report and track administrative or less-severe violations through mitigation, rather than prosecuting all violations, which would increase efficiency and help prioritize resources. Under this approach, according to NERC, issuing a warning would not be materially different than issuing a notice of penalty with a zero-dollar penalty. NERC does not believe a separate process for issuing warnings is required at this time.¹⁵⁶

205. NERC indicates that it and the Regional Entities have developed a *pro-forma* settlement agreement that Regional Entities may use when a registered entity is performing the necessary task, but certain documentation may be incomplete or missing. The *pro forma* settlement agreement would apply to pre-determined Reliability Standard requirements in a given set of circumstances, and would eliminate some of the administrative process currently required to bring a violation to the filing stage. NERC notes that the Commission may need to accept an abbreviated record for such a filing.¹⁵⁷

206. NERC observes that the variability of time required by the various Regional Entities to process enforcement actions, and the variability of results have been greater than desired. NERC states that it is in the best position to ensure consistency in Regional Entity enforcement actions, but that its role in the Regional Entities' development of notices of alleged violation, which identify to registered entities alleged violations and initiate the CMEP process that could result in a finding of violation and a penalty after a hearing, has been limited to date. NERC also notes that it currently does not have a process review of the initial notice or record of the proceedings. Thus, in NERC's view, the compliance process as presently implemented has been inefficient, requiring NERC to loop back to Regional Entities multiple times while it is reviewing enforcement actions. NERC argues that streamlining interactions between the Regional Entities and NERC to avoid multiple loop backs in the process of developing the record and determining proposed penalties would increase efficiency. To that end, NERC states that it will permit Regional Entities to ask for help and advice in advance of issuing notices of alleged violation or before proffering proposed settlement agreements to registered entities. Alternatively, NERC believes the Regional Entities must take on additional

¹⁵⁶ *Id.* at 31-32.

¹⁵⁷ *Id.* at 32-33.

responsibility to ensure that their actions achieve consistency and efficiency. NERC intends to address these issues when it negotiates the next generation of delegation agreements.

207. In the Regional Entities' joint self-assessment report that NERC included in its filing, the Regional Entities identify several significant accomplishments concerning the CMEP program through the date of the filing, including:¹⁵⁸ the completion of processing 5,039 self-reported compliance violations filed prior to the mandatory enforcement date for Reliability Standards; the receipt of approximately 1,400 self-reported or self-certified possible violations from registered entities since the mandatory enforcement date; the conduct of nearly 600 compliance audits that identified over 600 possible violations; and the receipt of thousands of periodic self-certifications provided by registered entities.

208. To improve performance and build upon the initial successes of the CMEP, the Regional Entities recommend that NERC, along with the Regional Entities, refine the implementation of decentralized compliance monitoring and enforcement by providing clear standardized procedures, active controls, clearly articulated performance metrics, and checks or audits of performance to guide Regional Entity performance. The Regional Entities state that NERC and Regional Entities should mutually operate with more transparent, clear, and frequent communications among the compliance authority staffs. The Regional Entities also suggest that NERC should not replicate the Regional Entity's initial investigatory work when considering a Reliability Standards violation, but should establish clear, transparent metrics for review and acceptance of Regional Entity actions except in unusual or problematic cases or where assistance is requested by the Regional Entity.

209. The Regional Entities further suggest that NERC should communicate clear expectations to Regional Entities and provide training to promote greater consistency in implementation and interpretation of Reliability Standards. NERC and the Regional Entities also should collaborate in development of compliance information systems that provide seamless flow and processing of compliance information from registered entities, through the regions, to NERC.

210. According to the Regional Entities, they and NERC should help registered entities better understand compliance requirements and processes, while protecting confidentiality rights and due process, by publicly sharing lessons learned, providing

¹⁵⁸ *Id.*, Att. 4 at 3-4.

examples of what is necessary to demonstrate compliance, and identifying common mode failures that have led to past non-compliance.

211. The Regional Entities suggest that the NERC Board of Trustees Compliance Committee, which reviews Regional Entity penalty determinations before filing them with the Commission, select unique cases with precedential value and issue its decision, either approving or remanding a case, to all Regional Entities (non-publicly) regardless whether the Board Compliance Committee develops a written opinion on a case.

212. The Regional Entities believe that they and NERC should adopt procedures for expediting processing of minor or documentation-related violations. Regional Entities urge NERC to establish baseline penalty amounts for violations of particular requirements that would have relatively low penalties, in the order of a few thousand dollars, to reduce the disproportionate burden on Regional Entities in processing such cases and to minimize inconsistencies between regions.

Comments

213. EPSA supports NERC's efforts to adopt simplified approaches to addressing settlements and compliance issues. However, EPSA notes, the "short-form" settlement option established previously by NERC is not being used as widely as many had hoped. EPSA encourages NERC to seek new ways to process documentation violations and eliminate the burden that documentation and administrative violations currently represent, and urges the Commission to support an approach that minimizes the administrative burden associated with documentation errors and focuses on material aspects of reliability enforcement.¹⁵⁹

Commission Conclusion

214. The Commission observes that most issues NERC and the Regional Entities raise concerning their implementation of the Compliance Monitoring and Enforcement program are transitional issues that NERC and Regional Entities are resolving to a significant degree by their own efforts. Since NERC's filing in this proceeding, NERC has filed with us many more notices of penalty, the vast majority of which have needed no further review.¹⁶⁰ These notices of penalty dramatically increase the information

¹⁵⁹ EPSA Comments at 11-12.

¹⁶⁰ See, e.g., *North American Electric Reliability Corp.*, 129 FERC ¶ 61,119 (2009) (Omnibus Notice of Penalty Order) (concluding that the Commission will not

(continued...)

available to registered entities on practices that may violate Standards requirements and penalties Regional Entities so far have assessed. They also provide clarity regarding practices that demonstrate compliance. Therefore, the Commission expects NERC and the Regional Entities to continue to resolve many issues identified in the Performance Assessment, particularly during the ongoing renegotiation of the Delegation Agreements.

215. Nevertheless, the Commission agrees with NERC and the Regional Entities that their compliance processes must become more efficient and resolve alleged violations more quickly so as to provide to the industry greater transparency about violations, related penalties, and lessons learned. The Commission believes, however, that a fundamental restructuring of the respective roles of NERC and the Regional Entities is not needed to achieve this goal. Rather, we believe that the Regional Entities should continue to receive and process most alleged violations, while NERC in its oversight role should assess and assure consistency and appropriate treatment for the processes by which Regional Entities address alleged violations and the penalties Regional Entities determine. In performing its oversight function, NERC must provide training to Regional Entities and disseminate to each Regional Entity information and direction resulting from its review of proposed violations and penalties from all eight Regional Entities.

216. NERC can maximize consistency and appropriateness of treatment in compliance matters most efficiently if it has the ability to advise or provide direction to Regional Entities at an early stage after the receipt of an alleged violation. For this reason, we support the suggestions of the Regional Entities for the NERC Board of Trustees Compliance Committee to increase communications with Regional Entities regarding its decisions. These processes should minimize the “loopbacks” NERC believes to have delayed its filings of notice of penalty. NERC must retain discretion to review Regional Entity investigations and other specific compliance matters and if appropriate, take them over or remand them to the Regional Entity with directions on further work.¹⁶¹

217. We also agree that development of reasonable metrics for assessment of the Regional Entities’ performance of their compliance functions will increase efficiency of the enforcement process, provide incentives for effective, timely handling of Regional

further review 564 penalties for alleged or confirmed violations in a single Notice of Penalty).

¹⁶¹ NERC has proposed revisions to its delegation agreements to address these matters, which are pending in Docket No. RR10-11-000. The Commission will rule on these matters in the context of that proceeding.

Entity caseloads, and furnish important data for the next Performance Assessment. To advance the goal of obtaining integrated compliance information that would populate these metrics and increase the efficiency of the compliance process, we support NERC and the Regional Entities' development of a non-public central compliance data hub. Information from this data hub could be made public on a coordinated basis to notify registered entities of aggregated compliance information, lessons learned, evidence that would support compliance with particular requirements and information about notices of penalty concerning specific types of violations, as NERC suggests. We direct NERC to report, in the informational filing due six months after the issuance of this order on the timeline and plan for development of this data hub, including details regarding how it will operate, what information it will contain, and whether it will supplant existing processes for providing non-public data to the Commission.

218. One method that NERC and Regional Entities advocate to process enforcement matters more efficiently is to streamline procedures for handling less serious alleged violations. To this end, as we have stated previously, the Commission encourages NERC and the Regional Entities to develop flexible approaches to align the record and format of notices of penalty to the relative significance of violations, such as *pro forma* settlements and proposals for "parking ticket" or "speeding ticket" approaches that could minimize the administrative burden of performing each step in the Compliance Monitoring and Enforcement process for every violation. For example, minor alleged violations subject to a "parking ticket" approach could be aggregated and reported to the Commission quarterly, rather than through individual notices of penalty. We agree with NERC that Regional Entities should seek to "bundle" multiple alleged violations into a single settlement when that can be done: in fact, we have declined to review further a number of notices of penalty that incorporate such settlements.¹⁶² We concur that, as Regional Entities urge, NERC and Regional Entities should consider development of "baseline" penalties for particular types of less serious violations. We likewise encourage NERC and Regional Entities to address and submit for our consideration appropriate procedures and penalties for resolving purely documentation-related violations, i.e., instances in which a registered entity cannot provide data or documents showing its compliance with a particular requirement but can provide some other assurance of its performance or that

¹⁶² See, e.g., *North American Electric Reliability Corp.*, 130 FERC ¶ 61,078 (2010) (no further review of notice of penalty incorporating a settlement of 30 alleged violations by the City of Cleveland, Ohio).

it otherwise is fulfilling completely the reliability objective of the requirement.¹⁶³

Documentation is not the goal in and of itself. However, documentation is necessary to establish a reasonably auditable demonstration of compliance and may reinforce focus on attaining the performance required by a Reliability Standard.

219. At this time, we cannot accept the proposed development of a “warning ticket” that would not require a Regional Entity and a registered entity to state their conclusions about whether a violation has occurred. As we stated in the Omnibus Notice of Penalty Order, the Commission expects an increasing level of compliance with the Reliability Standards as registered entities gain more experience with mandatory Reliability Standards.¹⁶⁴ This expectation emphasizes an important consideration for penalty determinations: a registered entity’s compliance history. We are concerned that an improperly designed “warning ticket” mechanism may allow a registered entity to receive a warning for practices that violate a Reliability Standard requirement, thereby resulting in an insufficient recognition of a registered entity’s compliance history in a subsequent penalty matter. If NERC still wants to pursue a “warning ticket” mechanism, it must explain how the mechanism would work without running afoul of the concerns raised above. NERC is free to provide that explanation in the informational filing or, if it chooses to take additional time to develop the mechanism, in a later filing.

220. We agree that NERC and Regional Entities should consider using risk-based approaches to maximize the effectiveness and timeliness of CMEP activities such as compliance audits and spot checks. We remain concerned whether use of risk-based approaches is consistent with NERC’s commitment to perform compliance audits of all registered entities on either a three-year or six-year cycle. We direct NERC to explain in the informational filing required by this order how it would implement risk-based approaches to compliance activities and at the same time complete its currently-required audit cycles.

¹⁶³ We bear in mind our statement in Order No. 693 that in some instances it is impossible to separate the existence of documentation with a registered entity’s compliance with a Reliability Standard requirement. Order No. 693, FERC Stats. & Regs. ¶ 31,242 at P 256.

¹⁶⁴ Omnibus Notice of Penalty Order, 129 FERC ¶ 61,119 at P 41.

2. NERC's Evaluation of Each Regional Entity

221. In Attachment 3 of the Performance Assessment, NERC provides an evaluation of each Regional Entity's compliance activities.¹⁶⁵ NERC explains that the evaluation includes an analysis of statistics and performance metrics that reflect averages over a nearly two-year period. NERC notes that, as the compliance effort is still in its "nascent" stage, there are no baselines for trends analysis, however, NERC plans to add to and refine the performance metrics over time.

222. With respect to FRCC, NERC states that FRCC needs to improve its timeliness in: (1) reporting alleged violations to NERC; (2) issuing notices of alleged violation; (3) confirming violations and issuing notices of confirmed violation or entering into settlement agreements; and (4) obtaining Board of Trustees Compliance Committee approval of confirmed violations. NERC relates that FRCC recently has increased its compliance program staffing and, as of the Performance Assessment filing date, had the second lowest number of registered functions per full-time equivalent (FTE) committed to compliance of any Regional Entity.¹⁶⁶

223. NERC views MRO as an effective Regional Entity. NERC indicates that MRO should improve by providing accurate statements of fact for each violation and assess penalties according to the facts of each situation. NERC has concerns about several of MRO's compliance processes, which NERC has not yet reviewed or approved. NERC states that although these methods may be effective, they are not consistent with NERC practices and could lead to inconsistency with other regions.¹⁶⁷

224. NERC views NPCC as effective in that it is processing and completing identified violations in a timely manner. However, NERC is concerned that NPCC's low level of alleged violations per registered reliability function may indicate that NPCC is not identifying all violations that are occurring. NERC points out that, among the Regional Entities, NPCC had the second highest number of FTEs committed to the compliance program and the highest ratio of registered functions per compliance FTE as of the

¹⁶⁵ See Performance Assessment, Att. 3 at 12-27.

¹⁶⁶ *Id.*, Att. 4 at 15.

¹⁶⁷ *Id.* at 17.

Performance Assessment filing date. NERC states that it will continue to work with NPCC to improve its process for compliance violation investigations.¹⁶⁸

225. NERC and its outside auditing firm independently audited RFC's compliance program and found no material deficiencies. NERC observes that RFC was the first Regional Entity to receive approval from the NERC Board of Trustees Compliance Committee for a notice of penalty that imposed a non-zero dollar penalty. NERC notes that RFC does need to find ways to increase its efficiency with respect to conducting enforcement activities.¹⁶⁹

226. NERC views SERC as an effective Regional Entity. NERC audited SERC's compliance program and did not find any material deficiencies, but urges SERC to improve on its timeliness in issuing notices of alleged violation. NERC notes that SERC continues to use industry volunteer subject matter experts in addition to its own staff on compliance audits.¹⁷⁰

227. As of the filing date of the Performance Assessment, NERC views SPP Regional Entity as less effective in administering its compliance program than some other Regional Entities. NERC commends SPP Regional Entity for its ability to accurately identify high risk violations, but is concerned about SPP Regional Entity's ability to process alleged violations to completion in a timely manner and its situational awareness capabilities. NERC notes that SPP Regional Entity has been unaware of events that occurred within its footprint, while NERC and the Commission were aware of those events. NERC states that among the Regional Entities, SPP Regional Entity stands eighth in FTEs committed to the compliance program and second in the number of registered functions per compliance FTE.

228. NERC rates TRE as an effective Regional Entity, commending TRE for focusing on identifying higher risk violations and noting that TRE excels in processing alleged violations through completion. NERC does have questions about a contrast between TRE's high percentage of "failure to perform" violations and low number of violations

¹⁶⁸ *Id.* at 19. We note that some entities are registered for multiple functions, such as a transmission owner that is also registered as a transmission operator, balancing authority, generation owner and generation operator, among other functions.

¹⁶⁹ *Id.* at 20-21.

¹⁷⁰ *Id.*, Att. 3 at 21-22.

TRE has recommended for a non-zero dollar penalty. NERC states that it will continue to explore these concerns with TRE.¹⁷¹

229. NERC states that WECC is “one of the less effective Regional Entities” to date, but notes that WECC made significant progress in the spring of 2009, particularly with respect to processing a backlog of violations.¹⁷² NERC points out that although, as of the Performance Assessment filing date, WECC had the highest level of FTEs committed to the compliance program among the Regional Entities, WECC had the fourth highest ratio of registered functions to compliance FTEs. NERC notes that, due to the violations processing backlog, WECC cancelled all compliance audits scheduled for the fourth quarter of 2008 without coordinating with NERC. According to NERC, WECC also took several other unilateral actions, including issuing compliance bulletins containing Reliability Standards interpretations and/or guidance. NERC indicates that it will continue to work with WECC to resolve these issues. NERC also suggests that WECC create stronger separation between its compliance encouragement efforts and its enforcement activities, examine its staffing levels and compliance processes and stay focused on processing violations to completion.

Commission Conclusion

230. The Commission generally supports NERC’s specific recommendations for each Regional Entity. We expect NERC to be proactive in ensuring that the Regional Entities implement them. We note that NERC expresses concern about several “unilateral actions” by particular Regional Entities. We agree, for example, that a Regional Entity should not unilaterally delay a major portion of its compliance program without reasonable prior notice to NERC and an opportunity for NERC to suggest alternatives or to refer the matter to us. Such notice would enable NERC, the Regional Entity in question, other Regional Entities and, perhaps, the Commission or its staff, to take steps to address the situation.

3. Individual Regional Entity Issues

231. The Commission’s April 19, 2007 Order approving NERC’s delegation agreements with the Regional Entities directed NERC to address two topics in its initial three-year performance assessment. The Commission directed NERC to address (1) the

¹⁷¹ *Id.* at 24-25.

¹⁷² *Id.* at 26-27.

SPP Regional Entity's governance structure and independence from the SPP Regional Transmission Organization and (2) the WECC Reliability Standards development procedure's stakeholder voting structure.¹⁷³

a. SPP Independence

232. In its conditional approval of the SPP Regional Entity delegation agreement, the Commission, citing Order No. 672, noted that serving both as a Regional Entity and an RTO in a region creates an inherent conflict of interest.¹⁷⁴ While the Commission did not prohibit an entity from serving in both roles, Order No. 672 emphasized that a heavy burden would be required to demonstrate a strong separation of functions as between the ISO or RTO on one hand and the Regional Entity on the other.¹⁷⁵ To address concerns over SPP Regional Entity's independence, the Commission directed NERC to provide a discussion in its first performance assessment addressing the effectiveness of the SPP bylaws in ensuring an adequate separation of functions as between SPP RTO and SPP Regional Entity Trustees.¹⁷⁶

233. In the Performance Assessment, NERC states that while the SPP Regional Entity governance structure and independence from the SPP RTO generally were legitimate subjects for monitoring and further review at the time of the delegation agreements order, a number of developments and analysis since that time have substantially mitigated any concerns in this area. NERC's filing addresses distinct actions that have been taken by NERC and SPP to ensure adequate separation. First, NERC explains that the SPP Inc. Bylaws have subsequently been amended in numerous respects, that the SPP Registered Ballot Body has five voting sectors, and that membership is not a requirement for any participation in the SPP Regional Entity Reliability Standards development process, including registration in the registered ballot Body and voting on the Regional Standards.

¹⁷³ Delegation Agreements Order, 119 FERC ¶ 61,060 at P 401-02, 474-75, Ordering Paragraph (D).

¹⁷⁴ *Id.* at P 396 (citing Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 698-700).

¹⁷⁵ *Id.*

¹⁷⁶ Delegation Agreements Order, 119 FERC ¶ 61,060 at P 402.

234. Next, NERC discusses a compliance filing which was made with the Commission to address lingering concerns that the SPP Markets and Operation Committee and SPP Board of Directors/Members Committee had the capability to indefinitely remand or terminate a draft Regional Reliability Standard. NERC reiterates its position that the Commission's concerns were not well founded.

235. NERC's filing goes on to discuss the Commission staff's independence audit of SPP Inc., noting that in its order addressing the staff audit report, the Commission found that there will be an appropriate separation as between SPP's RTO and Regional Entity functions, subject to the following actions among others: (i) the retention, by SPP of a full time Regional Entity manager to oversee all delegated functions of the Regional Entity and to serve as SPP Regional Entity's primary representative to NERC; (ii) authorization, on the part of the SPP Regional Entity manager, to authorize withdrawals from the SPP Regional Entity bank account, consistent with the SPP Regional Entity budget; and (iii) authorization, on the part of the SPP Regional Entity, to account for funds available to the Regional Entity and to address discrepancies resulting from an audit, bank account reconciliation or internal review of the Regional Entity's segregated funds.

236. Finally, NERC notes that through a series of Commission approved filings, SPP has taken actions to ensure that SPP Regional Entity revenues, expenditures and funds are properly recorded and accounted for and segregated from revenues, expenditures and funds of SPP Inc.

Commission Conclusion

237. The Commission acknowledges that in the years following its initial directive, a number of developments have occurred which substantially mitigate the Commission's concerns over SPP Regional Entity's independence. Specifically, the Commission notes that (1) SPP has taken actions to ensure that SPP revenues, expenditures, and funds are properly recorded and accounted for in accordance with NERC's system of accounts, and (2) SPP has implemented a number of recommendations made by Commission staff after its independence audit of SPP, including the hiring of a full time Regional Entity manager.

238. However, with respect to the Commission's independence audit of SPP Regional Entity, the Commission believes that NERC has mischaracterized the nature of our decision in that order. The Commission clarifies that our finding of appropriate separation as between SPP's RTO and Regional Entity functions related only to those

areas which were assessed by Commission staff during the course of the audit, so that the Commission then did not assess the overall independence of SPP's Standards Development Process.¹⁷⁷ As a result, prior to this order the SPP Regional Standards Development Process was never certified to be independent by the Commission. The Commission notes that it has maintained a standing objection to certain aspects of SPP's Regional Standards Development Program in the years since conditionally accepting SPP's Regional Delegation Agreement.¹⁷⁸

239. Due to a number of factors, however, the Commission now finds that SPP's Standards Development Process provides adequate separation between the SPP RTO and SPP Regional Entity. In making this determination, the Commission has carefully considered (1) the explanation and assurances provided by NERC and SPP in their February 17, 2008 compliance filing, (2) the subsequent amendments to SPP's bylaws that implement recommendations made by Commission staff in the independence audit, and (3) developments in SPP's 2010 Business Plan and Budget.

240. In their February 17, 2009 compliance filing, NERC and SPP explained that the role of the Markets and Operations Committee and SPP Board of Directors/Members Committee was purely advisory and assured the Commission that neither Committee could significantly delay or terminate a draft Regional Reliability Standard. With regard to the role of the SPP Markets and Operations Policy Committee and the SPP Board of Directors' involvement in conducting advisory votes of the Regional Standards, the Commission concludes that, due to the recent modification of the SPP bylaws that implement recommendations made by the independence audit, this concern has substantially abated.

241. An additional factor which tends to demonstrate that greater independence is being achieved by SPP Regional Entity is that in FY 2010, SPP Regional Entity has indicated that it will staff its Standards Development Program with a dedicated employee, rather than partial time of several employees with multiple responsibilities. This is a significant improvement from SPP Regional Entity's previous budgets, under which it has utilized shared staff to complete this function. The Commission views SPP Regional Entity's projected staffing in 2010 as a positive step toward maintaining a "strong separation"

¹⁷⁷ See *Southwest Power Pool, Inc.*, 126 FERC ¶ 61,045 at P 5 (2009).

¹⁷⁸ See, e.g., *Delegation Agreements Order*, 119 FERC ¶ 61,060, at P 396; *North American Electric Reliability Corp.* 122 FERC ¶ 61,245, at P 212 (2008); *North American Electric Reliability Corp.* 125 FERC ¶ 61,330, at P 108-110 (2008).

between the Regional Entity and RTO functions and believes that such staffing decisions are appropriate for entities like SPP Regional Entity that possess joint functions.

b. WECC

242. In the Delegation Agreements Order, the Commission acknowledged NERC's concern regarding WECC's voting structure. Specifically, NERC indicated that it was concerned that the multiple stakeholder classes typical in other Regional Entities are, in WECC, combined into two broad classes, leaving unclear whether the WECC voting model, at the committee and subordinate structure level, satisfies the FPA section 215 requirement regarding the need for a balance of stakeholder interests. However, we agreed with WECC that its choice of transmission provider and transmission customer classes for committee voting can be considered fair and balanced under the circumstances presented.

243. NERC now indicates that subsequent developments and experience have allayed NERC's original concern regarding the effectiveness of WECC's stakeholder voting structure. NERC states that WECC has modified its bylaws and its process for developing and approving regional Reliability Standards in ways that address NERC's concerns about the voting structure for WECC regional Reliability Standards. In addition, NERC notes that in the stakeholder survey conducted as part of preparing the three-year assessment report, 68 percent of respondents agree that the WECC Reliability Standards development process has been open and inclusive and provides adequate opportunities for interested stakeholders to provide comments.

Commission Conclusion

244. The Commission accepts NERC's explanation that its original concern with the WECC voting structure has been mitigated by subsequent actions and experience. The Commission believes that WECC's bylaw modifications sufficiently address the concerns articulated previously by the ERO; further, the Commission recognizes the polling statistics cited by the ERO regarding the WECC Reliability Standards development process as being open, inclusive, and providing adequate opportunities for stakeholders to comment on the process. We therefore conclude that WECC's voting model adequately balances stakeholder interests and continues to meet the certification criteria under section 215 of the Federal Power Act.

The Commission orders:

(A) The Commission hereby accepts NERC's Three-Year Performance Assessment and finds that NERC has demonstrated that it continues to satisfy the

statutory and regulatory requirements for ERO certification set forth in section 215(c) of the FPA and section 39.3(b) of our regulations, as discussed in the body of this order.

(B) The Commission hereby finds that the Regional Entities have demonstrated that they continue to satisfy the statutory and regulatory requirements set forth in section 215(e) of the FPA and section 39.3(c) of our regulations, as discussed in the body of this order.

(C) The Commission directs NERC to file with the Commission quarterly reports within 30 days of the end of each quarterly period, beginning with the fourth quarter of 2010, through and including the fourth quarter of 2013, on voting results in the Reliability Standard development process, as discussed herein.

(D) The Commission directs NERC to develop a plan to address capacity and energy in its reliability assessment methodology and a timeline for executing the plan, and submit the plan and timeline as part of the 2011 Long-Term Reliability Assessment, as discussed herein.

(E) The Commission directs NERC to submit an informational filing addressing the directives, concerns and requests for information and/or feasibility reports discussed herein, within six months of the date of this order.

(F) The Commission directs NERC to identify and address the prioritization of Reliability Standards projects in its annual Reliability Standards Development plan beginning with the plan for 2012, as discussed herein.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Appendix A Index of Directives

| <u>Paragraph No.</u> | <u>Directive</u> |
|----------------------|--|
| ¶ 62 | Directs NERC to submit an informational filing six months from the date of this order updating the Commission on NERC’s progress in prioritizing and implementing the various action items. |
| ¶ 76 | Directs NERC to consider the following practices for use during the Standards development process as possible means to accomplish these objectives: (1) posting proposed regional Reliability Standards for comment from the continent-wide pool of interested stakeholders for consideration, while allowing the regional open processes to make final determinations to be submitted to NERC; (2) providing for comments from NERC technical staff on proposed regional Reliability Standards; and (3) including regional Reliability Standards in other NERC review processes that it uses for continent-wide Reliability Standards. We further direct NERC to discuss its considerations regarding these suggestions in the informational filing due six months from the date of this order. |
| ¶ 85 | Renews the directive that NERC submit quarterly reports on standards development for additional three years, with additional detail of required analysis. |
| ¶ 126 | Directs NERC to continue its oversight of Regional Entity audits with NERC staff that are technically proficient. |
| ¶ 127 | Directs NERC and Regional Entities to have their staff, and Commission staff where applicable, discuss the appropriate role of observers during their pre-audit meetings or conferences. |
| ¶ 169 | Directs NERC to establish criteria it will use to select a subset of events, which should focus on those with the highest impact to reliability, to provide important “lessons learned” and submit the criteria in the informational report. |
| ¶ 170 | Directs NERC to work with the Regional Entities to ensure that they provide to Commission staff sufficient and timely |

information on each event. NERC must report on steps it will take to implement this directive in the informational report.

- ¶ 171 Directs NERC to develop communication protocols between NERC, the Commission and the Regional Entities for use during events and report on its progress in the informational filing.
- ¶ 178 NERC shall report on the steps it has taken to clarify the interface between event analyses and compliance activities, including CVIs, in response to the Commission's guidance in the informational filing.
- ¶ 178 Directs NERC to include, in its informational filing due six months after the issuance of this order, the procedures to be used within its Operations and Engineering function relating to the communication and exchange of event analysis and investigative information, and procedures under which the Operations and Engineering function will communicate event analysis and investigative information to the compliance staff of NERC or a Regional Entity.
- ¶ 180 Directs NERC to continue developing scenario analysis in the long-term reliability assessments using the criteria noted above. We require NERC to update its reliability assessment protocols to establish a requirement for an annual scenario analysis and to file this update in the informational filing.
- ¶ 183 Directs NERC to develop a plan to address capacity and energy in its reliability assessment methodology and a timeline for executing the plan, and submit the plan and timeline as part of the 2011 Long-Term Reliability Assessment and file its preliminary plan and timeline in the informational filing.
- ¶ 185 Directs NERC to consider establishing permanent data bases that could be automatically populated with: (i) new transmission projects data from the Regional Entities, (ii) generation interconnection queue data, and (iii) other data relevant for reliability assessment. We require NERC to discuss the feasibility of this improvement, and to the extent databases covering this information already exist, discuss how to better utilize or integrate that information into the Reliability Assessments in the informational filing.

- ¶ 195 Directs NERC to include a report in the informational filing detailing the feasibility of establishing a NERC-led Strategic Planning initiative utilizing multiple year budgets.
- ¶ 217 Directs NERC to report, in the informational filing, on the timeline and plan for development of a non-public central compliance data hub, including details regarding how it will operate, what information it will contain, and whether it will supplant existing processes for providing non-public data to the Commission.
- ¶ 220 Direct NERC to explain in the informational filing how it would implement risk-based approaches to compliance activities and at the same time complete its currently-required audit cycles.
- Paragraph No. Other Actions
- ¶ 12 The Commission will hold a second Commissioner-led technical conference to discuss reliability monitoring, enforcement, and compliance issues in November 2010. The Commission will work with NERC and Canadian regulators develop an agenda for this conference.
- ¶ 13 The Commission will hold a Commissioner-led conference in either January or February of 2011 and will work with NERC and Canadian regulators on identifying a date and appropriate topics for discussion.
- ¶ 57 NERC should continue to seek recognition in Canada and Mexico, as appropriate and keep the Commission informed about the status of those efforts.
- ¶ 138 Agrees that NERC should develop performance metrics that help to ensure consistent implementation of the compliance enforcement process across the regions.
- ¶ 152 Encourages NERC to intensify its efforts to provide additional oversight and guidelines to assist registered entities in accurately determining that an asset is critical to the Bulk-Power System. (critical cyber asset identification)

¶ 219

Provides that if NERC still wants to pursue a “warning ticket” mechanism, it must explain how the mechanism would work without running afoul of the concerns raised. NERC is free to provide that explanation in the informational filing or, if it chooses to take additional time to develop the mechanism, in a later filing.