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NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL

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May 27, 2004

The Honorable John D. Dingell, Ranking Member
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515-6115

Dear Congressman Dingell:

This letter responds to your letter dated May 13, 2004, inquiring about the “organizational independence” of the regional reliability councils that make up the North American Electric Reliability Council (NERC). Your letter notes findings in the final report of the U.S.-Canada Power System Outage Task Force regarding the governance of and arrangements for compensating employees of the East Central Area Reliability Coordination Agreement (ECAR). You ask whether the circumstances in ECAR also exist in the other regional reliability councils. You also note that the final report recommends “a regulator-approved mechanism for funding NERC and the regional reliability councils, to ensure their independence from the parties they oversee.” You ask whether NERC agrees with this recommendation and, if so, what steps are being taken to implement it.

I have included with this letter an attachment describing, for NERC and the ten regional reliability councils, the information you seek concerning governance and employee compensation. ECAR is the only regional council whose employees have their payroll administered by one of its member companies (FirstEnergy).

The final report acknowledges that the task force found no evidence to suggest that ECAR staff favors FirstEnergy’s interests relative to other ECAR members. Nevertheless, I am informed that the ECAR Executive Board recognizes that the long-standing salary and benefits administration arrangement ECAR has with FirstEnergy is now perceived as a conflict of interest situation. To address this matter, the ECAR Executive Board has directed that alternatives to this arrangement be developed for consideration and action by the board. I am told it is the Executive Board’s plan to implement a different arrangement for providing salary and benefits administration for the ECAR staff as soon as practical. Under the coming new arrangement, ECAR staff salary and benefit programs will have no affiliation with any ECAR member.

I am further informed that the salary and benefits administration issue is only one of several matters being evaluated by the ECAR Executive Board in the broader context of restructuring ECAR to ensure that ECAR will meet the governance and other requirements for regional

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reliability organizations as set forth in the reliability legislation currently pending in Congress.¹ ECAR has established an Executive Board Task Force with the assignment to develop recommendations for a restructured ECAR. Recommendations are expected to be brought to the ECAR Executive Board later this year for consideration.

With respect to the funding issue, NERC and its regional councils have long believed it is important to have an independent mechanism, with appropriate regulatory oversight, for funding the standard-setting and compliance activities of NERC and the regional councils. Such a funding mechanism is one of the benefits to be derived from the reliability legislation currently pending in Congress. Under that legislation, an electric reliability organization approved by FERC must, among other things, have established rules that "allocate equitably reasonable dues, fees and other charges among end users for all activities under this section."² Thus, FERC must approve the funding mechanism proposed by an ERO applicant. Since 1999, NERC and its regional reliability councils, supported by a broad coalition of industry, regulator, and consumer stakeholders, have been urging Congress to adopt that legislation. Without it, a sufficient legal framework does not exist for establishing an adequate funding mechanism with appropriate regulatory oversight. Of course, that legislation would also redress today's circumstance of voluntary compliance by making the reliability rules mandatory and enforceable.

NERC agrees that the organization responsible for bulk power system reliability should be funded in a manner that preserves its independence of action, and with appropriate regulatory oversight. This does not mean, however, that the ERO's budget should be set without regard for the views of those who participate in and depend upon the bulk power system. NERC believes in strong involvement by stakeholders to ensure total transparency of process and development of viable policies. The pursuit of independence must stop short of excluding participation by, or ignoring the concerns of, consumers and industry participants. This includes the proper oversight of expenses to assure accountability, regardless of how the funds are collected. Stakeholder participation should and can be balanced by including representation by the industry's diverse business, consumer, and regulatory interests. Broad stakeholder participation in the development of rules and policies for the reliability of the bulk electric system is also essential. That participation brings a high level of technical expertise and resource commitment. Neither NERC nor the regional councils could function in the absence of substantial stakeholder involvement.

Thank you for your interest in these important issues regarding the reliability of the bulk electric system. Please contact me if I may be of further assistance in this or any other matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael R. Gund", with a long horizontal flourish extending to the right.

¹ See e.g., H.R. 6, "Energy Policy Act of 2003" (conference report); and H.R. 3004, "Electric Reliability Improvement Act of 2003."

² See e.g., H.R. 6 Conference Report, Section 1211, adding new FPA Section 215(c)(2)(B).

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cc: The Honorable Joe Barton, Chairman
Committee on Energy and Commerce

The Honorable Ralph Hall, Chairman
Subcommittee on Energy and Air Quality

The Honorable Rick Boucher, Ranking Member
Subcommittee on Energy and Air Quality

Regional Reliability Council Chairmen:

ECAR — Michael Core

MAPP — James Averweg

ERCOT — Michael Greene

NPCC — Charles J. Durkin, Jr.

FRCC — Richard J. Midulla

SERC — Terry Boston

MAAC — P.R.H. Landrieu

SPP — Al Strecker

MAIN — Peter Steitz

WECC — Ronald D. Nunnally

Attachment

ORGANIZATION: North American Electric Reliability Council (NERC)

NUMBER OF EMPLOYEES: 42

PAYROLL ADMINISTRATION: Self with commercial vendor.

BENEFITS STRUCTURE: 401(k) plan with matching contribution; defined contribution plan; investments limited to set of diversified mutual funds; plans are independently managed and administered by a major national financial services firm.

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: Board includes 9 independent trustees elected by stakeholders and 1 management trustee.

CONFLICT OF INTEREST PROVISIONS: Board and staff subject to code of conduct and conflict of interest restrictions that preclude investment in or business relationships with bulk electricity market participants.

ORGANIZATION: East Central Area Reliability Coordination Agreement (ECAR)

NUMBER OF EMPLOYEES: 18

PAYROLL ADMINISTRATION: FirstEnergy, an ECAR member

BENEFITS STRUCTURE

STOCK BENEFITS: ECAR employees are members of FirstEnergy's 401(k) retirement plan, receiving FirstEnergy stock as a matching share of employee contributions.

EMPLOYEE STOCK

PURCHASE PLANS: Employees may purchase additional FirstEnergy stock.

BONUS POLICIES

(ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE):

None

GOVERNANCE: The policy-making body of ECAR is the Executive Board, populated by ECAR's members.

CONFLICT OF INTEREST PROVISIONS:

Neither ECAR staff nor board members are required to divest stock in ECAR member companies.

ORGANIZATION: Electric Reliability Council of Texas (ERCOT)

NUMBER OF EMPLOYEES: 399

PAYROLL ADMINISTRATION: ERCOT's payroll and benefits are administered through a contract with independent service providers.

BENEFITS STRUCTURE: Employee benefit investment plans (401(k) and Money Purchase Plan) are independently managed and administered by a major national financial services firm.

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: ERCOT is governed by a "hybrid" Board of Directors comprised of a combination of stakeholders (selected by ERCOT members in each market segment), consumers, and unaffiliated members. The Board's 14 seats are allocated as follows: 1 investor-owned utility, 1 municipal utility, 1 electric cooperative, 1 independent retail electric provider, 1 independent generator, 1 independent power marketer, 1 industrial consumer, 1 commercial consumer, 1 residential consumer, 3 unaffiliated members with no ties to any ERCOT stakeholders, ERCOT CEO, Texas Public Utilities Commission Chair (non-voting).

CONFLICT OF INTEREST PROVISIONS: The compliance office functions independently from the ERCOT operations staff and reports directly to the ERCOT CEO.

ERCOT employees are prohibited from having direct financial interest in any market participant company. Employees must sign an Ethics Agreement asserting that they have divested any financial interest in any company doing business in the ERCOT market.

ERCOT Board members and staff are required to observe explicit and detailed antitrust guidelines.

ORGANIZATION: Florida Reliability Coordinating Council (FRCC)

NUMBER OF EMPLOYEES: 10

PAYROLL ADMINISTRATION: FRCC manages its own payroll.

BENEFITS STRUCTURE: Self-directed 401(k) plan; defined benefit pension plan (FRCC is in the process of terminating the Defined Benefit Plan and implementing a Defined Contribution Plan).

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: Governed by a Board of Directors consisting of the following six sectors:

Power Marketer
Generator
Non-investor Owned Utility Wholesale
Load Serving Entity
Generating Load Serving Entity
Investor Owned Utility

CONFLICT OF INTEREST PROVISIONS:

FRCC has a Conflict of Interest and Business Ethics policy, which states:

“Employees or relatives of employees should not own a ‘significant’ financial interest in any business organization, nor serve in its employment in any way, that does or seeks to do business with the FRCC, or any member system, unless such interest has been fully disclosed in writing to the President and/or is common knowledge to the President.”

ORGANIZATION: Mid-Atlantic Area Council (MAAC)

NUMBER OF EMPLOYEES: 10 full-time equivalents — 4 spend full-time on MAAC — all are PJM employees

PAYROLL ADMINISTRATION: MAAC’s administrative requirements for payroll and benefits are met through a service contract with PJM Interconnection.

BENEFITS STRUCTURE: MAAC’s salary and benefits programs are totally independent of any member or transmission customer.

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: Balanced stakeholder Board with 11 members, 2 from each of the following sectors, plus the PJM President:

- Gen Owners
- Transmission Owners
- Distribution Co.’s
- End-Use Customers
- Other Suppliers

Members Committee with over 250 representatives.

CONFLICT OF INTEREST PROVISIONS: Employees receive annual training on the Code of Conduct, which prohibits employees from having any financial interest in or other dealings whatsoever with any MAAC or PJM member or member-affiliated company.

Those employees performing compliance and enforcement functions for MAAC have independent authority to issue reports and bring compliance and enforcement matters to the attention of appropriate forums without the approval of PJM Interconnection Board of Managers or officers.

ORGANIZATION: Mid-America Interconnected Network, Inc. (MAIN)

NUMBER OF EMPLOYEES: 27 (with the transfer of RTO functions to others, MAIN expects to have 11 employees by the end of the summer).

PAYROLL ADMINISTRATION: The Executive Director determines salary levels within limits set by the member-approved budget. The program is managed by a commercial vendor.

BENEFITS STRUCTURE: Self-directed employee benefit investment plans (401(k) and Money Purchase Plan) are independently managed and administered by a major national financial services firm. There are no options for purchasing stocks of individual companies.

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: Governed by a stakeholder board of directors with sector representation (four sectors: 2 people each plus four at-large).

CONFLICT OF INTEREST PROVISIONS: MAIN does not require its employees to divest themselves of stock of member companies.

ORGANIZATION: Mid-Continent Area Power Pool (MAPP)

NUMBER OF EMPLOYEES: 18 full-time, 4 part-time

PAYROLL ADMINISTRATION: In 1990, the members of MAPP formed MAPPCOR, a Minnesota Nonprofit Corporation, to provide services to its members. MAPPCOR operates much like a cooperative under the IRS Code Section 501(c) (12). Payroll is administered by MAPPCOR through a payroll service provider, Ceridian.

BENEFITS STRUCTURE: MAPPCOR has its own benefit and compensation plans that are completely independent and separate from any member plans. MAPPCOR directly funds other customary employee benefits including an employee incentive pay program, military leave, family or medical leaves, etc.

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: MAPP has a representative stakeholder board called the MAPP Executive Committee, which reflects the diversity among MAPP members in terms of size, type of entity, and geographic location. The governing document of MAPP has been filed and accepted by FERC.

CONFLICT OF INTEREST PROVISIONS: MAPPCOR has an Employee Manual that includes a Standards of Conduct patterned after the requirements of FERC Order 889 and a Conflict of Interest Policy that applies to members and employees.

ORGANIZATION: Northeast Power Coordinating Council (NPCC)

NUMBER OF EMPLOYEES: 14

PAYROLL ADMINISTRATION: Structure: Bandwidths consistent with, but independent of Con Edison Management Salary Structure.

Administration: Independent — Chairman and Executive Director

BENEFITS STRUCTURE:

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: Executive Committee
2 voting classes (transmission provider, transmission customer) — up to 10 reps in each class
Currently transmission providers = 9 and transmission customers = 6

CONFLICT OF INTEREST PROVISIONS: Annual execution of NPCC Code of Conduct; there are no restrictions on stock ownership in NPCC companies.

ORGANIZATION: Southeastern Electric Reliability Council (SERC)

NUMBER OF EMPLOYEES: SERC staff (9 full-time, 5 part-time) are covered under employment contracts.

PAYROLL ADMINISTRATION: Compensation is managed by SERC staff with oversight by SERC officers.

BENEFITS STRUCTURE: None

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: Board of Directors — stakeholder representation:

- Investor Owned
- Federal/State
- Electric Cooperative
- Municipal
- Exempt Wholesale Generator
- Power Marketer
- Customer

CONFLICT OF INTEREST PROVISIONS: Each SERC staff member is required to execute a confidentiality agreement before he or she can have access to SERC member information and data; SERC has no policy concerning divestiture of stock holdings in SERC member companies.

ORGANIZATION: Southwest Power Pool (SPP)

NUMBER OF EMPLOYEES: 124 (soon to be 142) — 8 full-time employees allocated to Reliability Council functions.

PAYROLL ADMINISTRATION: No affiliation of any kind to a member or customer.

BENEFITS STRUCTURE: No affiliation of any kind to a member or customer.

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: 7-person, complete non-stakeholder Board of Directors.

CONFLICT OF INTEREST PROVISIONS: Annual execution of a standards of conduct; there are restrictions on stock ownership in SPP members or customers.

ORGANIZATION: Western Electricity Coordinating Council (WECC)

NUMBER OF EMPLOYEES: 25

PAYROLL ADMINISTRATION: Salary and benefits administered by WECC or its agents.

BENEFITS STRUCTURE: WECC 401(k) plan

STOCK BENEFITS: None

EMPLOYEE STOCK PURCHASE PLANS: None

BONUS POLICIES (ADDITIONAL STOCK TIED TO CORPORATE PERFORMANCE): None

GOVERNANCE: 27 board members
7 non-affiliated independents
20 from 5 stakeholder sectors (4 each)

CONFLICT OF INTEREST PROVISIONS: Required to abide by a conflict of interest policy; there are restrictions on stock ownership in WECC companies.