

NERC

NORTH AMERICAN ELECTRIC
RELIABILITY CORPORATION

Overview of Compliance Enforcement Initiative

September 21, 2011

RELIABILITY | ACCOUNTABILITY



- Staff from NERC and the Regional Entities have been working on key enforcement initiatives
 - Re-focus industry efforts on achieving reliability excellence through attention to matters posing greatest risks to reliability
 - Reduce undue regulatory burdens on users, owners, and operators
 - Improve caseload processing

- BOTCC approval of 63% more violations per month in 2011 than in 2010 (114/month vs. 70/month)
- Increased collaboration with Regional Entities on assessing risk
- Cooperation between NERC and Regional Entities on development of records to support dispositions of violations

- NERC and the Regional Entities solicited feedback over the summer from representatives of registered entities
 - Learning firsthand about the impacts of compliance enforcement processing on registered entities
 - Making compliance a means to ensuring reliability, not an end all by itself
- NERC and the Regional Entities incorporate feedback, when possible, about important initiatives and ongoing programs
 - Little differentiation between time and resources spent on minor violations and more serious violations
 - Self-reports take too long to process and the perceived benefit is minimal
 - Too much focus on finding and processing any “related violations” stemming from a single set of facts

- Find-Fix-Track-Report
 - Handling reliability issues without all of the processes related to violations and penalties
 - Applied in both Compliance Monitoring and Enforcement Processing
- Streamlined Notices of Penalty
 - Spreadsheet NOP Format

Refocus efforts on reliability excellence, eliminate undue regulatory burdens, streamline paperwork requirements, and encourage continued timely and thorough self-reporting and mitigation.

Differentiates issues of noncompliance based on the level of potential risk to the reliability of the bulk power system. All instances of noncompliance will continue to be identified and mitigated. Issues that pose a more serious risk to the reliability of the bulk power system will be filed at the Federal Energy Regulatory Commission on a monthly basis in a further streamlined spreadsheet Notice of Penalty format or full Notice of Penalty as appropriate. Matters that pose a lesser risk to reliability will be processed on a “find, fix, track and report” spreadsheet that will be submitted on a monthly basis to FERC as an informational filing.

- After four years of enforceable reliability standards, additional differentiation of violations based on risk is essential
 - Recognizing the experience of the Regional Entities, NERC, and FERC in assessing violations
 - Building on the success of Abbreviated NOPs and the Administrative Citation Process
- Proportionality and discretion are two hallmarks of effective enforcement organizations

Differentiating Violations

- NERC, the Regional Entities, and FERC recognize that not all violations pose the same risk to reliability, so they should not all be treated the same
- By processing every violation through to a Notice of Penalty, the focus is put on enforcement instead of on enhancing reliability
 - Provide incentives for ensuring reliability instead of threatening sanctions for compliance failures

- At any stage, Regional Entities may evaluate and categorize violations
 - Review of possible violations
 - Value of detailed self-reports that describe scope of violation, corrective action plan, and analysis of actual and potential risk
 - Guidance to registered entities on effective self-reporting
 - Auditors may recommend candidates in Phase I
 - Enhanced auditor training from the start of the program
- Regional Entity decides if the violation should be processed through to a Notice of Penalty
 - Assigning value to the issuance of a penalty for the specific violations

The Evaluation of Candidates

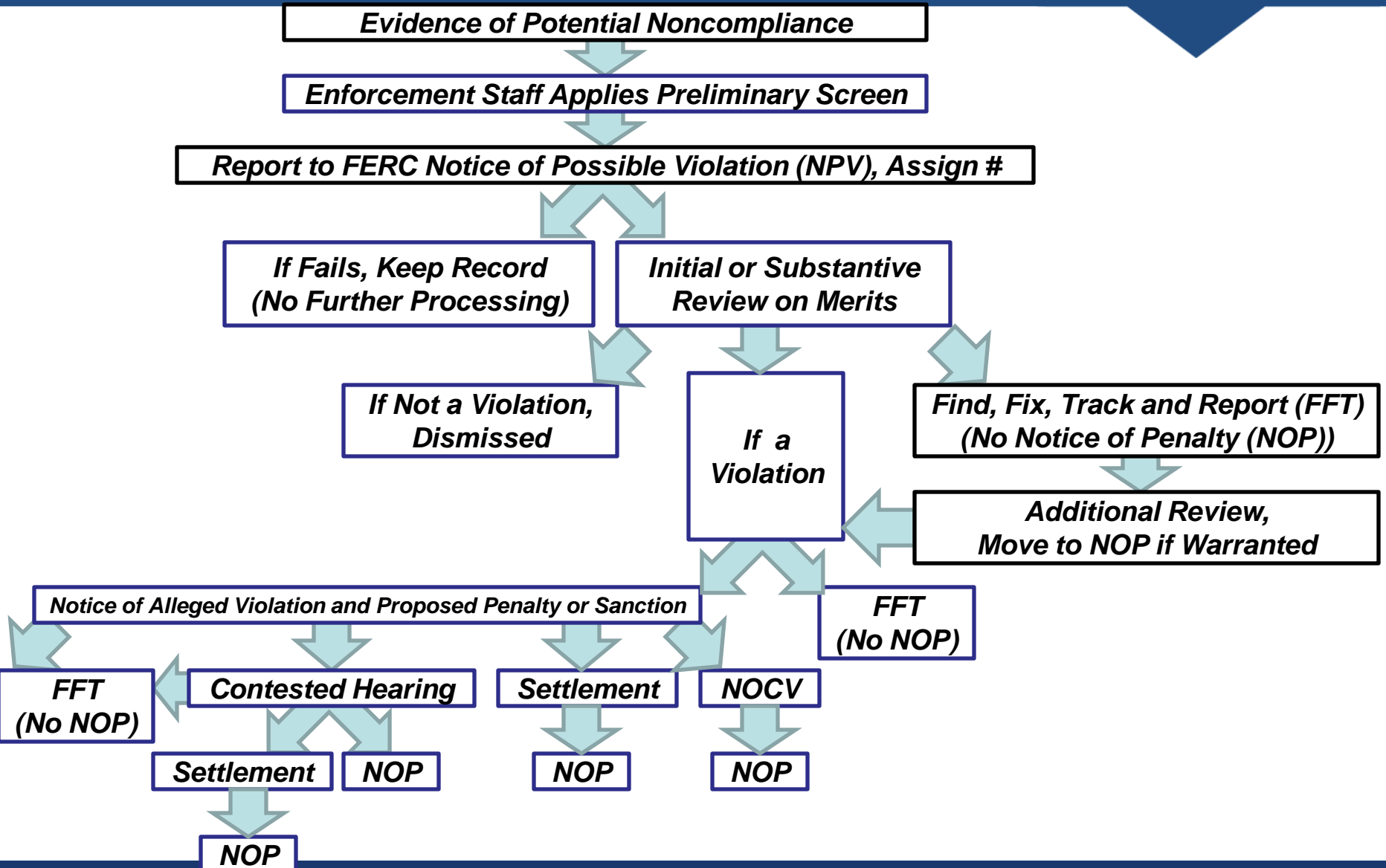
- Assessing whether a Notice of Penalty is warranted will take into account:
 - the risk of the violation,
 - the deterrence value of a penalty, and
 - lessons that can be conveyed to the registered entity or industry from the specific penalty

- There are two levels of risk assessment
 - Risk assessments of the entity: should be done periodically to inform compliance monitoring methods and frequency
 - Risk assessment of the PV: should be done in the context of the risk assessment of the entity and the compliance history
 - Accounts for both actual and potential risk to reliability
- In relation to both of these levels, an entity's internal compliance program and internal controls, to include reporting and fixing, are significant pieces of this equation

- Risk Assessment
 - Moderate-Serious vs. Minimal-Moderate
- VRF/VSL
- Other Key Factors
 - Priority Reliability Standards
 - Self-Reporting
 - Compliance Program, Internal Controls, and Culture of Compliance
 - Compliance History

- Handling of violations will still hinge on the assessment of risk
 - The Regional Entity must have enough information to determine that the actual or potential risk of the violation is minimal or moderate and does not warrant imposition of a penalty
- Important to avoid rigid rules or parameters
- Essential to have flexible considerations that will evolve with experience

High Level Steps - Proposed Process



- Regional Entities will track and report all reliability issues that have been identified
 - If there is not a violation, then a dismissal will still be appropriate.
- Reporting will include the name of the registered entity, a factual description of the matter, and the basis for not pursuing a Notice of Penalty
- All instances of potential non-compliance will be mitigated
 - Registered entity describes finished or proposed mitigation activities and certifies completion—*found problems must be fixed*
 - Regional Entities verify as needed

- NERC and the Regional Entities will use sampling to review possible violations not pursued to a Notice of Penalty
 - Future audits and spot checks
- If registered entities do not follow through on mitigation, the Regional Entity may assess an aggravated penalty in the future
- Possible violations not pursued to Notice of Penalty will become remediated issues and part of the registered entity's compliance history

- Filing with FERC on September 30 to include the Regional Entities' first remediated issues subject to FFT
- Monthly filings will include matters subject to FFT treatment

- NERC will build on the success of prior streamlining efforts by consolidating NOPs into a spreadsheet format
 - With Omnibus and ACP filings, over one-third of all violations processed have been filed in a spreadsheet format
- The new spreadsheet format will be used for all violations, except for those that posed a serious or substantial risk to the reliability of the bulk power system
 - Full NOPs will still be used for serious or substantial violations or for exceptional cases
- This format eliminates the need for voluminous attachments

- The spreadsheet will include all of the information necessary to evaluate the relationship of the penalty to the seriousness of the violation
 - Region
 - Entity Name, NCR#
 - Standard and Requirement violated
 - VRF/VSL
 - Violation Description
 - Risk Assessment
 - Penalty amount
 - Description of Mitigation Activity
 - Dates
 - Discovery method
 - Admits, Neither Admits Nor Denies, or Does Not Contest
 - Factors affecting penalty (violation history, ICP, etc.)

- This proposal reflects a significant shift in emphasis in compliance and enforcement processing. There are two currently planned phases for implementation:
 - Phase I commences in September 2011
 - Phase II will involve CEA Compliance staff making determinations, during audits, spot checks and investigations, as to the treatment categories, without CEA Enforcement oversight, as well as determinations by CEA Enforcement staff as to particular facts and circumstances

- Possible violations identified in all compliance monitoring methods qualify for FFT Report consideration
 - CEA Compliance staff may recommend that a possible violation be treated as an FFT to CEA Enforcement staff
 - CEA Enforcement staff may review and confirm the FFT recommendation or determine NOP treatment is warranted
 - In addition, CEA Enforcement staff also may determine that FFT treatment is warranted when possible violations are presented in the enforcement space

- The Phase II transition date has not been set but is targeted for 12 to 18 months after initiation of Phase I and will be informed based on developments in Phase I
 - This phase will be predicated on an increased training and certification program for CEA Compliance staff that will commence during Phase I for auditors and investigators in the field

- Determinations regarding compliance issues made in the field will be based on:
 - Basic auditing concepts and principles
 - Reasonable assurance
 - Significance
 - Audit risk
 - The entity
 - Registered functions
 - Internal compliance program
 - Compliance history
- Key reliability risks and priorities

- Consistent use of audit tools, practices and procedures are paramount and will be core to the training program to ensure consistent auditing
 - One such tool is the ERO Sampling Methodology that provides for a clear, statistically-proven method for determining sample size. The sampling methodology also provides for the appropriate qualitative assessment for ensuring a sample set is consistent with the intent of the program.

- EA auditors are recruited based on industry and/or auditing experience; a significant number of the CEA auditors possess certifications such as NERC Certified System Operator, or are credentialed in the IT or auditing fields
- CEA auditors are expected to exercise judgment; fundamental auditing principles clearly state this, along with the concept that individual expertise and professional qualifications are to be considered in compliance monitoring programs

- Phase III future options could include reporting remediated issues to the CEA but not including them in a report to FERC
 - This will likely require Rule of Procedure changes
 - The success of Phase I and Phase II will be instructive to the potential success of such a Phase III approach

- Monthly calls/meetings with Regional Entities and trade associations will be held to gain feedback on the program
- Ongoing ERO review of the initiative will occur over the next nine to twelve months to determine further areas of improvement or efficiency gains and to track success of the program
- Ongoing discussions with Commissioners and Commission staff to gain feedback on the program
- Additional focus group meetings to assess progress of the initiative

- The spreadsheet template includes the required documentation information
 - NERC does not expect there to be detailed backup information beyond the information included in the spreadsheet
 - NERC does not expect there to be settlement agreements associated with FFT
 - NERC is not requiring that an entity admit to the possible violation, but the entity must mitigate the possible violation and the risk to reliability must be described briefly in the spreadsheet

- The FFT format will further transparency and consistency of treatment of possible violations
 - Initially, a searchable Excel spreadsheet will be used to convey the disposition and key issues including the factual description of the remediated issue, mitigating activities, and the risk assessment until such time as NERC and the Regional Entities automate the process
 - This will facilitate identification of patterns and trends more quickly by the ERO and industry
 - Form FFT letters to entities and FFT (as well as NOP) spreadsheets will facilitate uniformity in the presentation of information

- The ERO may conduct spot checks and sampling with respect to FFT remediated issues
 - Because the FFT Report is not an NOP, entities must understand that FERC is not expected to act on the filing and is not limited to action within the thirty (30) day period established for NOPs
 - FERC has authority under 18 C.F.R. Section 1b to review issues included in a FFT Report

- We are not looking to reduce the number of violations; we are looking to improve the way we process them
- Effective implementation of the proposed initiatives will improve reliability and risk management
 - Escape the mindset that every wrong must be punished and focus on the greatest risks to reliability

NERC remains committed to ensuring reliability by maintaining accountability for all stakeholders in the compliance monitoring and enforcement process.