

ARE **YOU** PREPARED  
FOR A  
FERC STANDARDS AND CODE OF  
CONDUCT COMPLIANCE AUDIT?

The Eleventh Annual FERC Briefing  
EXNET/Bruder, Gentile & Marcoux, L.L.P.  
The Next Generation of Issues for Utility Management

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# Highlights of the Year in Review

- FERC Order 2004 Technical Conference (5/04).
- FERC issues rehearing orders every four months: Orders 2004-A, B and C.
- Order 2004 compliance deadline (9/22/04).
- 19 audits complete or pending – based on public record.
- FERC OMOI Staff completes Phase I audits of OASIS/Internet website postings of electric transmission providers (1/05).
- FERC announces Phase II comprehensive audits to begin February 2005 (1/05).

Are **YOU** ready for a FERC audit?

NOW

NOW

NOW

is the time to conduct an  
internal compliance audit!

# The Stakes Are High

- FERC penalties and refunds in last 6 months include:
  - ❑ **AEP** - largest civil penalty in FERC history - **\$21 million** for providing a marketing affiliate with preferential storage services and improper access to gas storage information.
  - ❑ **Arizona Public Service** - **\$4 million** in damages for unauthorized use of P-T-P service.
  - ❑ **Tucson Electric** – **refunds** of Tucson's transmission revenues in excess of transmission O&M for preferential sales to affiliated marketer.
  - ❑ **Dominion Resources** - **\$500,000** civil penalty and **\$4.5 million** refunds to customers associated with improper access to gas storage information.
  - ❑ **Texas Eastern/Duke marketing affiliates** - **\$500,000** settlement payment for improper access to gas transportation and non-affiliated shipper information by marketing affiliates.

# The Stakes Are High

- Companies who have self-reported violations to FERC (e.g., Dominion Resources and CLECO) did not appear to get any break.
- FERC has imposed burdensome compliance plans for 3 and 4 – year periods.
- FERC remedies have included on-going monitoring of compliance, including the reporting of corporate hotline calls to FERC.

# What to Expect from a Phase II Audit

- 4-5 month FERC audit for 10 companies at a time
  - ❑ This is an aggressive and expedited schedule from past audits, which often lasted one year or more.
- Audit will cover only post-Order 2004 compliance, unless there is a significant violation requiring a review of historical compliance.
  - ❑ Past audits covered review of a historical period – typically 2001-2003.

# What to Expect from a Phase II Audit

- Selection of audited companies will truly be random.
  - ❑ Although selection of companies for past audits was supposed to be “random”, those audits were systematic – primarily based on region, non-RTO/ISO membership, and generation ownership:
    - ❖ 8 companies in Pacific Northwest;
    - ❖ 5 companies in Southwest;
    - ❖ At least 4 companies in South;
    - ❖ 2 companies in Midwest;
    - ❖ None in PJM, New York or New England.

# What to Expect from a Phase II Audit

- Baltimore Gas & Electric and Allegheny Power announced that they are among the first 10 companies.
- RTO/ISO members and non-generation owning companies are part of first 10 companies. Companies are from different U.S. regions.

# FERC's Phase II Audit Process

FERC OMOI Staff will:

- Notify the company of an audit – either by phone, public letter or both.
- Issue a very substantial initial data request.
- May issue follow-up data requests.
- Conduct an on-site physical inspection.

# FERC's Phase II Audit Process

- Verify substance of information posted on OASIS/Internet web site. (In Phase I, FERC simply verified that the information was posted.)
- Issue a draft, **non-public audit report** for company review and comment; the company will have an opportunity to respond.
- Establish compliance measures to address problems in the audit report.
- Conduct negotiation of compliance measures and any refunds/penalties.

# FERC's Phase II Audit Process

- Issue a public audit report - report will reflect company's response - especially if the company and FERC Staff disagree about a compliance issue.
  - ☐ FERC will strive to issue a report supported jointly by the company and FERC, i.e. where the company can agree to implement the recommendations.

# FERC's Phase II Audit Process

- Arizona Public Service and Tucson Electric audit reports will be the format going forward.
- The audit reports will be presented in a public forum, such as a FERC Commission meeting.
- FERC will issue audit reports – with good or bad results – in the future!

# How do you prepare for a FERC audit?

- You have a 4-5 month window until the next selection of 10 companies.
- Your Chief Compliance Officer (CCO), internal and/or external counsel should conduct an internal compliance audit.

# Basic Internal Audit Tasks:

- Test your **doors and key card** access – and review lists of people with key card access.
- Review your **computer controls** – FERC has expressed amazement at the amount of problems it has identified with improper access to computer information by Marketing and Energy Affiliate employees.
- Conduct **interviews** of employees – transmission, marketing, Energy Affiliates, managers, shared managers, and support employees with access to transmission information.
- Review **communications** – voice recordings, e-mails and other written communications between transmission and marketing/Energy Affiliates.

# Important Internal Audit Tasks:

## ➤ Implications of the Duke order

- ❑ Evaluate joint meetings of transmission and marketing personnel and whether Standards of Conduct measures are adequate.
  - ❖ If the CCO or an attorney is present at the meeting, is that enough protection?
  - ❖ Do you need a written record of the meeting?
  - ❖ FERC's "best practice" for compliance: written record.

# Important Internal Audit Tasks:

- Evaluate physical controls for transmission engineering and planning employees.
  - ❖ More transmission employees require physical separation measures (e.g. key cards, locked doors) than just those transmission employees working in the transmission control center.
  - ❖ FERC's "best practice" for compliance: key cards.
- Controls between generator operations and marketing employees.

# Important Internal Audit Tasks:

## ➤ What does Order 2004-C mean for rate design employees???

- ❑ FERC will consider actual duties and responsibilities of employees on a case-by-case basis.
- ❑ But "there are certain rate design functions that will be considered Transmission Functions because rates are an integral part of transmission service."

## ➤ Code of Conduct Review

- ❑ Utility and marketing affiliate must operate separately to the maximum extent practical.
- ❑ No sharing of market information between utility and marketing affiliate unless simultaneously disclosed to the public.

# What's Next?

- What Integrated Resource Planning models are acceptable under the Standards of Conduct?
  - ❑ FERC wants industry input.
  - ❑ Efforts are underway to form an industry coalition and request a FERC Technical Conference.
- FERC Meeting of CCO's (April ?, 2005, at undetermined location). The possible CCO agenda includes:
  - ❑ Self-audits and self-reporting of problems should be encouraged.
  - ❑ Development of a safe-harbor proposal.
  - ❑ Joint meetings – discussion of industry practices.

# What's Next?

- Look out for your audit letter from FERC!