

How to Survive a NERC Audit

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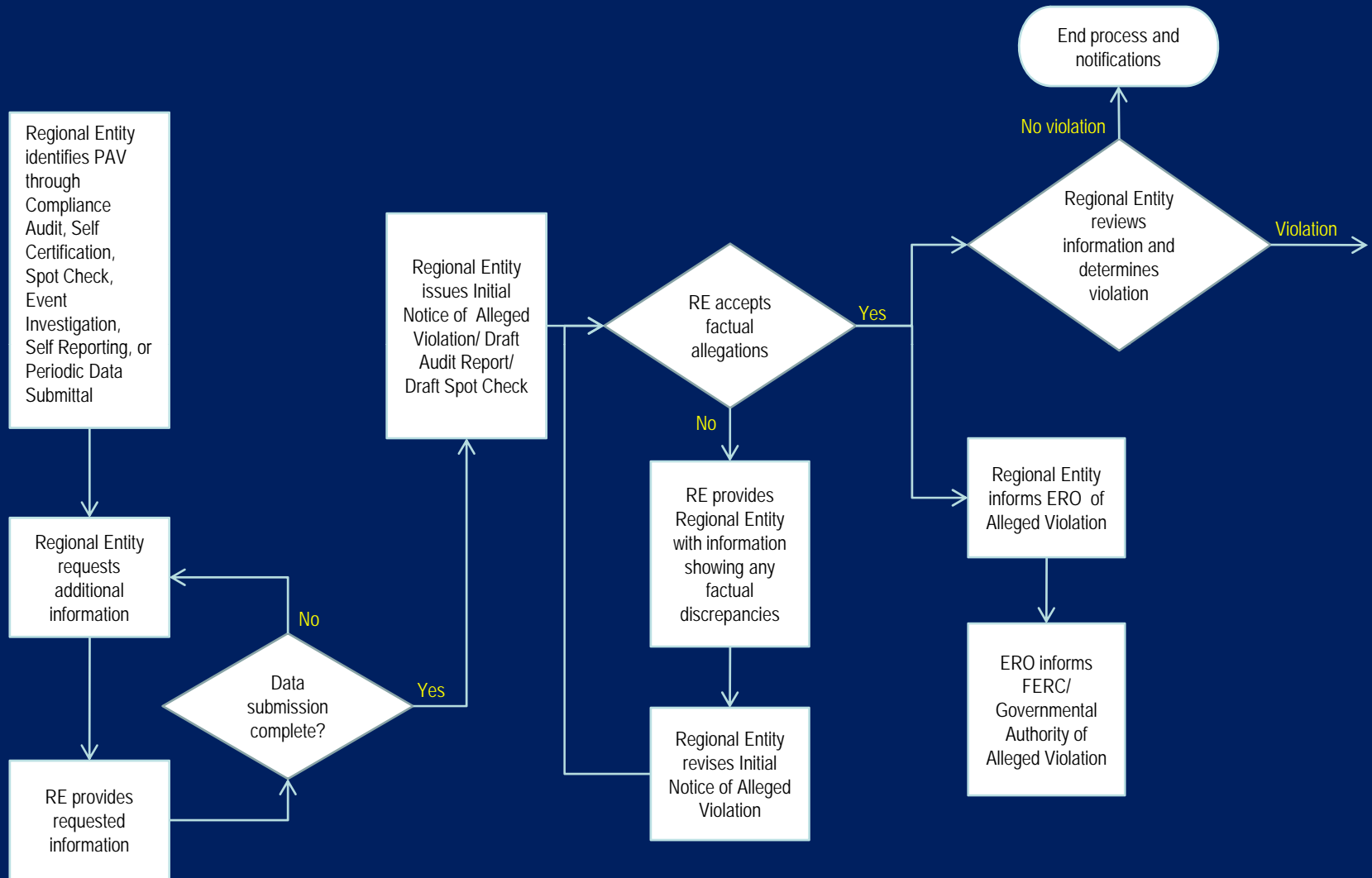


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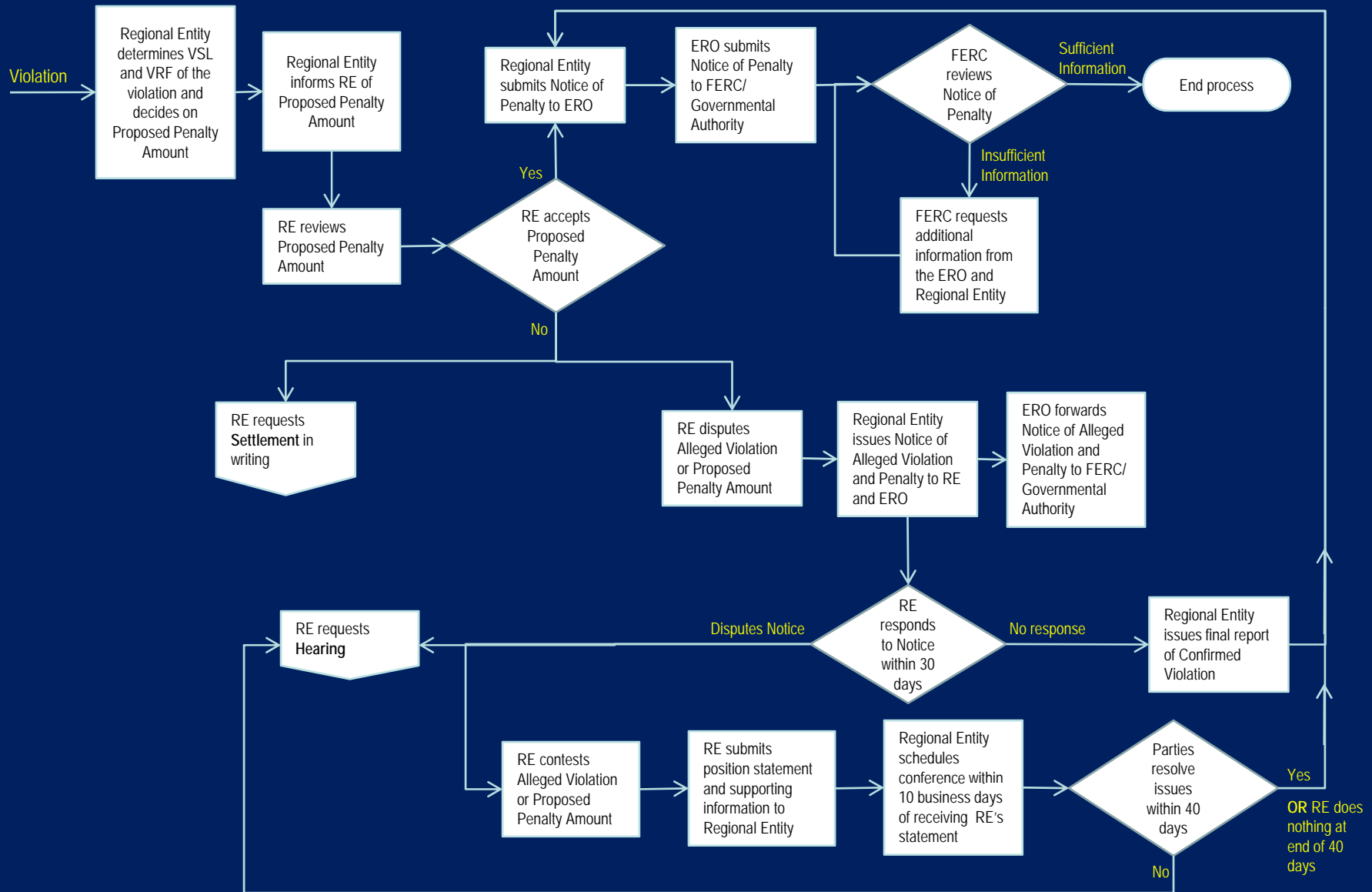
Rule No. 1: Don't Do Anything Wrong

- The process of resolving a Potential Alleged Violation can take more than a year and involve hundreds of hours of time.
- With three levels of de novo administrative review (Regional Entity, NERC and FERC), opportunities to settle or contest the Regional Entity's actions at numerous points and possible court appeals, the process can be extremely complex.
- The enforcement, settlement and hearing process can ruin your budget for legal expense.
- FERC is closely monitoring NERC and Regional Entity enforcement actions, and expects to become actively involved in the future. FERC appears to believe that penalties are not large enough.

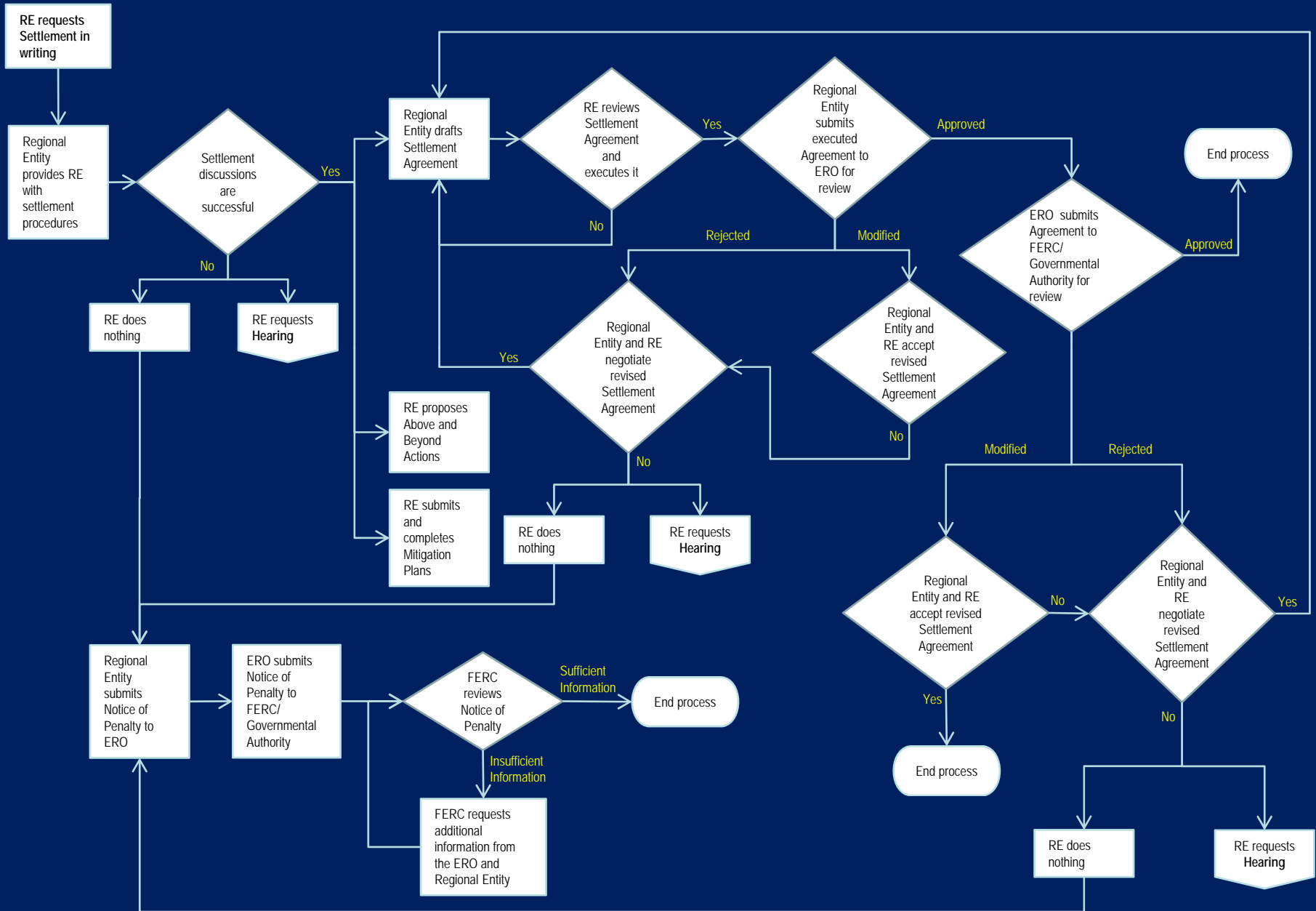
NERC Enforcement Process



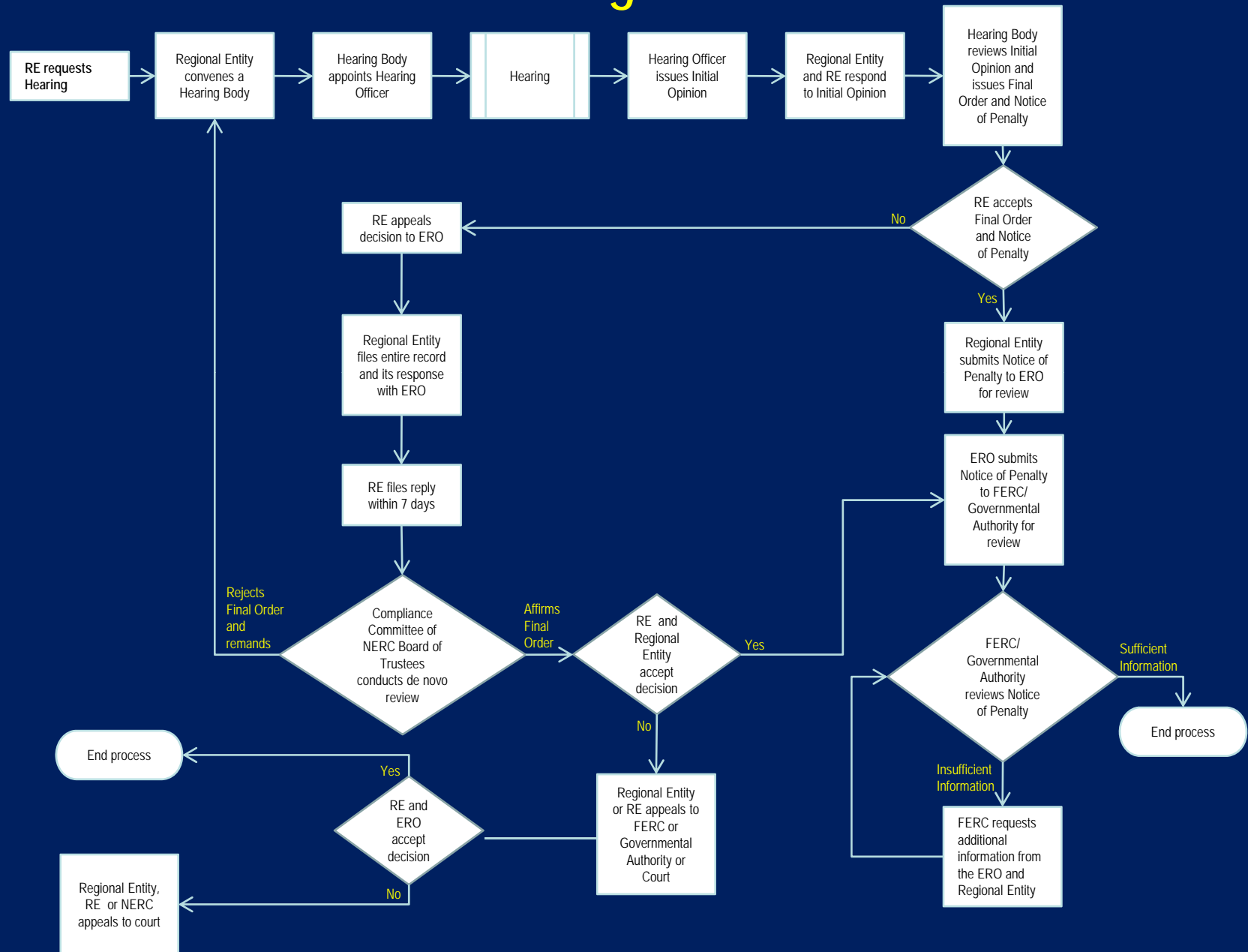
NERC Enforcement Process continued



NERC Settlement Process



NERC Hearing Process



Rule No. 2: Concentrate On Standards That Are Violated Most Frequently

- Through August 31, 2009, NERC submitted to FERC 72 Notices of Penalty for 188 violations of 23 Reliability Standards.
- 68 violations of CIP-001, Sabotage Reporting.
- 30 violations of PRC-005, Transmission and Generation Protection System Maintenance and Testing.
- 21 violations of FAC-008, Facilities Rating Methodology.
- 16 violations of FAC-009, Establish and Communicate Facility Ratings.
- 9 violations of PER-002, Operating Personnel Training.
- 44 violations of more than 120 other Reliability Standards.

Rule No. 3: Prepare Carefully for the Audit

- Using consultants to help prepare for an audit can reduce the likelihood of violations, but is not a guarantee.
- Failure to document compliance is nearly as bad as failure to comply.
- Counsel need to be closely involved in audit preparations as well as pre-audit compliance efforts. Not all engineers are equally skilled at interpreting the Reliability Standards.
- FERC has emphasized the importance of a robust compliance program, and stated that multiple violations may indicate a lack of a compliance program or overall lack of a compliance culture, which can affect penalty assessments.

Rule No. 4: Self-Report All Violations That You Find

- Self-reporting violations helps to demonstrate to the Regional Entity that you have a pro-active compliance program.
- Pro-active compliance programs are a factor that the Regional Entity considers in establishing penalties.
- FERC has stated that Self-Reports, which are voluntary disclosures, support reductions in penalty amounts; but self-certifications, which are required responses to Regional Entity inquiries, do not.

Rule No. 5: If The Regional Entity Identifies A Potential Alleged Violation, Be Prepared For A Long Process

- The Regional Entity will issue a draft report specifying the Potential Alleged Violation and notify NERC.
- The Regional Entity may submit informal requests to the Registered Entity (RE). The information-gathering process may take 1 – 3 months.
- The Regional Entity will schedule a telephone conference in which it summarizes its findings and states its proposed penalty based on the Violation Risk Factor and Violation Severity Level.

NERC's Base Penalty Table

	Violation Severity Level							
Violation Risk Factor	Lower		Moderate		High		Severe	
	Range Limits		Range Limits		Range Limits		Range Limits	
	Low	High	Low	High	Low	High	Low	High
Lower	\$1,000	\$3,000	\$2,000	\$7,500	\$3,000	\$15,000	\$5,000	\$25,000
Medium	\$2,000	\$30,000	\$4,000	\$100,000	\$6,000	\$200,000	\$10,000	\$335,000
High	\$4,000	\$125,000	\$8,000	\$300,000	\$12,000	\$625,000	\$20,000	\$1,000,000

NOTE: This table describes the penalties that could be applied for each day that a violation continues, subject to considerations regarding frequency and duration of the violation.

Rule 5: Be Prepared for a Long Process (continued)

- The RE may accept the proposed penalty, request settlement negotiations, or request a hearing. At least one Regional Entity prefers settlement discussions to immediate acceptance of a penalty.
- Settlement:
 - ❖ Settlement is not a means of getting the Regional Entity to withdraw an alleged violation; that is done in the hearing process.
 - ❖ An RE may state that it neither admits nor denies a violation in a settlement agreement. It may not contest whether the violation actually occurred.
 - ❖ The Regional Entity will not finally approve a settlement until the RE certifies completion of its Mitigation Plan.

Rule 5: Be Prepared for a Long Process (continued)

- If the Parties reach settlement, it must be reviewed by NERC and FERC. Either NERC or FERC can reject or require modification of the settlement. If this happens, either the RE or the Regional Entity can object, in which case negotiations begin again.
- If there is no settlement, the Regional Entity issues a public Notice of Alleged Violation. If the RE does not dispute the Alleged Violation or Penalty, the Regional Entity issues a final report of Confirmed Violation and NERC files it with FERC.
- If the RE disputes the Alleged Violation or the amount of penalty, the parties can either resolve the issue within 40 days or go to hearing.

Rule 5: Be Prepared for a Long Process (continued)

- The parties may adopt either shortened hearing procedures – essentially a paper hearing – (except in WECC, which has obtained FERC approval to not use them) or full hearing procedures with testimony, evidence and briefs. The initial decision is reviewed de novo by the Regional Entity's hearing body.
- The hearing body's decision is subject to de novo review by NERC's Compliance Committee and by FERC. Any changes by NERC or a remand by FERC may result in reopening the proceeding.

Rule 6: Begin Working On A Mitigation Plan Immediately

- Regardless of whether you intend to contest an Alleged Violation, begin work on addressing whatever problems the Regional Entity identifies.
- The time period in which a violation continues has a direct impact on the amount of a penalty.
- Speedy work on a Mitigation Plan also can demonstrate willingness to cooperate and a pro-active approach to compliance, which can affect the amount of penalty.
- Submitting a Mitigation Plan does not result in waiver of the right to contest the Regional Entity's decision.
- Most Regional Entities are willing to discuss and suggest improvements to draft Mitigation Plans that are submitted to them.

Rule No. 7: Be Sure The Mitigation Plan Is Effective

- Follow the Regional Entity's format for Mitigation Plans and respond to all questions. You can't re-argue whether a violation occurred, but you can discuss whether the violation had a significant impact on reliability of the Bulk Electric System.
- Follow NERC's rules: If the plan takes more than 3 months to implement, be sure that significant milestones are no more than 3 months apart.
- Be sure the plan corrects the alleged violations. You will be required to certify completion and provide convincing documentation.
- If NERC finds that the plan is ineffective or was not fully implemented, the penalty will increase.

Rule 8: Propose “Above and Beyond” Measures

- “Above and beyond” measures can include adopting a “best practice” that is not required by the Reliability Standard, industry outreach and education activities, or other actions that enhance reliability of the Registered Entity’s system or the Bulk Electric System.
- Actions that do more than simply correct a violation can reduce penalty amounts.
- “Above and beyond” measures can be a significant negotiating tool in settlement discussions.

Rule 9: Expect Variations Among The Regional Entities And Within Regional Entities

- The NERC Enforcement process will not mature for several years. During that time, individual auditors within Regional Entities almost certainly will have differing views as to what constitutes a violation.
- Regional Entities are interpreting Reliability Standards differently. REs in RFC complain that RFC is more strict than SERC, and REs in WECC complain that WECC is misinterpreting clear standards.
- Also, Regional Entities adopt regional standards that expand upon specific NERC Standards and may differ from region to region.
- The Regional Entities also vary in the size of penalties they assess.

Rule 9: Expect Variations Among The Regional Entities And Within Regional Entities continued

➤ Notices of penalties:

Regional Entity	Number of Penalties	Total Value of Penalties
MRO	15	\$135,000
SERC	37	\$588,000
All others	20	\$285,000
TOTAL	72	\$1,008,000