

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

North American Electric Reliability Corporation ) Docket No. FA11-21-000  
)

JOINT BRIEF OF THE AMERICAN PUBLIC POWER ASSOCIATION,  
THE EDISON ELECTRIC INSTITUTE, THE ELECTRIC POWER SUPPLY  
ASSOCIATION, THE ELECTRICITY CONSUMERS RESOURCE COUNCIL, THE  
LARGE PUBLIC POWER COUNCIL, THE NATIONAL RURAL ELECTRIC  
COOPERATIVE ASSOCIATION AND THE TRANSMISSION ACCESS POLICY  
STUDY GROUP

Pursuant to the June 4, 2012 “Order on Procedures” (“June 4 Order”) specifying further proceedings in this docket regarding the “Performance Audit of the North American Electric Reliability Corporation for Budget Formulation, Administration, and Execution” issued by the Commission’s Office of Enforcement pursuant to a delegated letter order on May 4, 2012 (“Audit Report”), the American Public Power Association, the Edison Electric Institute, the Electric Power Supply Association, the Electricity Consumers Resource Council, the Large Public Power Council, the National Rural Electric Cooperative Association and the Transmission Access Policy Study Group (jointly, “Trade Associations”) submit their joint brief responding to both the Audit Report and the Initial Brief of the North American Electric Reliability Corporation filed in this docket on July 19, 2012 (“NERC Brief”).

**I.**

**INTERESTS OF THE TRADE ASSOCIATIONS**

The Trade Associations filed joint comments in this docket on May 24, 2012, regarding possible procedures to be ordered in this docket for further consideration of the

Audit Report. Each of the Associations there described their respective memberships and interests in this matter.

Most important for present purposes, each of the Trade Associations have members that are currently listed on the NERC Compliance Registry, and thus are subject to the mandatory reliability standards and compliance regime set out in Section 215 of the Federal Power Act (“FPA”). All of the Trade Associations have participated in reliability-related industry activities on behalf of their members. They have appeared in numerous dockets before this Commission implementing the Commission’s and NERC’s responsibilities under the Section 215 regime. In addition, they actively participate in NERC’s own administrative processes and standards development activities, dedicating very substantial staff time to such participation, and facilitate and coordinate the participation of their individual members in such processes and activities. Finally, many of the members of the Trade Associations are load-serving entities, and are therefore responsible for payment of their allocated share of the NERC budget. Through their payment of the applicable charges, load-serving entities enable NERC to perform its function as the designated Electric Reliability Organization (“ERO”) under FPA Section 215.

For all of these reasons, the Trade Associations have a very strong interest in NERC’s activities, and in the ongoing relationship between NERC as the nation’s designated ERO and this Commission as NERC’s regulator under FPA Section 215. They appreciate the Commission’s decision to call for public comments on the Audit Report. The Trade Associations believe that the public procedures the Commission has adopted to obtain a more complete record prior to a final agency decision are appropriate. The Trade

Associations thank the Commission for instituting these procedures to allow for the orderly consideration of the issues, the presentation of the views of other interested parties, and action by the full Commission.

As to the substance of the Audit Report, the Trade Associations believe that the level of scrutiny to which the Audit Report subjects NERC, if approved by the Commission, would enmesh the Commission in NERC's management decision-making in a manner that would substantially hamper needed flexibility, while restricting important activities NERC has undertaken in support of industry reliability. The Trade Associations do not believe that this level of review is called for by Section 215 of the FPA, or contemplated by the Commission in Order No. 672, establishing the Commission's Rules governing ERO certification and addressing audits of the ERO.<sup>1</sup>

## II.

### **POSITION OF THE TRADE ASSOCIATIONS ON ISSUES RAISED IN THE AUDIT REPORT**

#### *1. The FPA and Order No. 672 Substantially Circumscribe FERC Audits of the ERO.*

The Trade Associations agree with the Commission's desire to ensure that NERC is carrying out its activities and functions under Section 215 both efficiently and effectively. As noted above, load-serving entities and the retail electric consumers they serve must pay in their rates for the costs of NERC's statutory activities. Hence, the

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<sup>1</sup> *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).

Trade Associations support the efforts of the Commission to oversee NERC's activities as the ERO, and have no quarrel with the examination of NERC's activities in its capacity as the ERO.

However, the Commission must be cognizant of the limits of its jurisdiction over NERC as the ERO. The FPA's sole reference to Commission oversight of NERC's expenditures lies in Section 215(c)(2)(B), which specifies that the Commission may certify the ERO if it has established rules that "allocate equitably reasonable dues, fees, and other charges, among end users for all activities under this section." The plain meaning of the statute is that Commission oversight of NERC is bounded by its review of rules which NERC itself must establish addressing the equitable allocation of reasonable costs. The Commission's ultimate authority in connection with such costs lies in its certification of the ERO. On the face of the statute then, the ambit of FERC's review of NERC's expenditures is quite unlike, and dramatically more circumscribed than, the Commission's oversight of jurisdictional utilities, over which FERC has direct rate authority under FPA Sections 205 and 206.

Addressing the scope of this oversight in Order No. 672, the Commission appropriately linked its auditing function to the ERO's compliance with statutory and regulatory criteria for certification. As the Commission held:

We contemplate that a compliance audit of the ERO would typically involve an examination of the ERO's ongoing compliance with statutory and regulatory criteria for certification and its performance in carrying out its responsibility to oversee the compliance with and enforcement of Reliability Standards.<sup>2</sup>

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<sup>2</sup> Order No. 672, at P 773. The Commission adds that it "...maintains the flexibility to determine the applicable scope of a particular audit." *Id.*

This approach is, of course, substantially different from the regime applicable to FERC-jurisdictional utilities. The scope of Commission audits of NERC under the statute and long-standing precedent is meaningfully more limited than is the case for audits of jurisdictional public utilities, over which the Commission maintains active rate authority. Instead, the statute contemplates that the Commission will review NERC's rules for allocating reasonable costs in connection with certification (and potential decertification) of the ERO, and that oversight of its costs is for the purpose of assuring that the ERO is complying with statutory and regulatory criteria. This framework plainly places primary authority for the oversight of NERC's expenditures with its governing board, and suggests a substantial degree of deference to the ERO, absent evidence that the organization is failing to accomplish statutory and regulatory objectives.

With this in mind, the Trade Associations are concerned by the extent to which the Audit Report's criticisms and recommendations delve into NERC's daily operations, accounting systems, employee compensation and functional activities. The Audit Report effectively proposes a more intrusive form of regulation for NERC than the Commission applies to other entities subject to Commission regulation, including Independent System Operators and Regional Transmission Organizations. The Trade Associations again thank the Commission for recognizing these concerns, and for instituting the procedures adopted in this case to allow for the orderly consideration of these issues.

2. *The Commission Should Act as NERC's Regulator, But Should Not Manage NERC's Management and Daily Activities.*

The Trade Associations are concerned that certain recommendations in the Audit Report go past the standard audit function and into the realm of managing NERC's

program activities, organization, personnel and management. One example is the Audit Report's recommendations (at 56-59) regarding the method of compensation of its Board members. The Commission Staff there asserted that NERC did not adequately support its decision to change from a per hour method of compensating its Board members to a flat fee method.

The Trade Associations believe that so long as the overall compensation levels for NERC Trustees are not out-of-line when compared to other not-for-profit organizations with similar specialized, critical infrastructure missions and the need for board members with specialized experience and qualifications, there is no need for the Commission to make any recommendations in this area. Even in the case of Commission-regulated public utilities, management decisions are entitled to a "presumption of prudence." *See California Independent System Operator Corporation v. FERC*, 372 F. 3d 395, 403 (D.C. Cir. 2004).

The same would go for the contention in the Audit Report (at 39-44) that NERC's studies used to determine employee compensation were not adequately supported and did not justify the reasonableness of the compensation that NERC has paid its employees. The Trade Associations in fact sympathize with NERC's difficulties in its area. Like NERC, the Trade Associations must recruit and retain qualified employees with highly specialized skill sets in the reliability area. It is very difficult to gauge how much must be paid to retain such staff and just who the competition for their services might be. Certain of the Trade Associations have employed their own consultants to assist in such matters. These consultants have struggled to develop salary comparables in this subject matter

area, and had to cast much further afield than is normally the case in trade association salary surveys.

For these reasons, the Trade Associations would urge the Commission to step back and carefully review the Audit Report, separating legitimate concerns regarding expenditures and internal controls from the Audit Report's no doubt well-intentioned but nonetheless intrusive *post hoc* review of NERC management decisions. In many instances, there is no one right answer to a management issue. In such cases, management decisions should be given appropriate deference in the absence of any showing of lack of diligence or inattention to relevant factors.

3. *Concerns About Whether NERC Expenditures Exceed the Scope of the ERO's Proper Activities Should Not Be Resolved in the Context of an Audit Proceeding.*

The Audit Report criticizes NERC for operating under the assumption that all of its projects, initiatives and tools are directly related to FPA Section 215, such that the costs are recoverable through the Section 215 assessment on load-serving entities. Audit Report at 70, 75-78. As NERC explains in its Brief (at 88-98), there are good reasons for NERC to make such an assumption: there have been numerous NERC filings and resulting Commission orders that support it. If the Commission intends to send a different signal to NERC now, a staff-developed Audit Report covering past activities and expenditures is not the right place to do it. These issues should be put on the table in a more appropriate, forward-looking forum.

For example, the Audit Report (at 75) questions activities NERC has undertaken as part of its monitoring the reliability and adequacy of the Bulk-power System ("BPS"). NERC's preparation of independent short- and long-term assessments of the reliability

and adequacy of the Bulk Electric System (“BES”)<sup>3</sup> focus attention on emerging issues that must be addressed to ensure BES reliability in future years. NERC’s statutory mandate extends beyond bare-bones reliability standards-drafting and compliance/enforcement activities, and the Commission has recognized this on multiple occasions. NERC Brief at 89-98. And as the Audit Report acknowledges (at 70), “FPA Section 215(g) requires that the ERO conduct periodic assessments of the reliability and adequacy of the bulk-power system in North America.” Yet the Audit Report states (at n. 48) that “[t]he degree to which such assessment and monitoring activities currently ongoing should be deemed statutory is therefore also an element that audit staff believes should be revisited.” The Trade Associations believe that the preparation of such reliability assessments falls squarely within the statutory duties of the ERO and in particular Section 215(g).

In any event, the better forum in which to resolve such scope issues is the budget process itself. There, the Commission and interested industry participants would have the opportunity to debate and resolve in advance which proposed NERC activities are (or are not) within the scope of Section 215. That is the proper way to hash out such potential controversies.

NERC in its Brief (at 100) states that it plans to develop written criteria for determining whether its activities are statutory to the Commission, through a stakeholder process that it will initiate in the fourth quarter of 2012 and complete in July 2013. It will then use these criteria in preparing NERC’s 2014 business plan and budget. The Trade

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<sup>3</sup> While Section 215 and the Audit Report use the term “BPS,” the Trade Associations use the term BES, since it is the defined term that NERC has used to delineate the universe of facilities to which its mandatory reliability standards will apply.



Associations believe that NERC's proposal should be accepted by the Commission, and that these criteria should be applied to the NERC budget as soon as practicable.

4. *NERC Must Have the Flexibility to Redirect Funds to Activities Within a Budget Year as Needed to Support Its Operations.*

The Audit Report expressed concern that NERC during the course of a budget year did not provide sufficient transparency regarding its use of previously budgeted funds, and from time to time redirected funds from one budget item to another, or to items that were not previously budgeted for, without disclosing this fact to its Board, the Commission, or stakeholders, and without obtaining Board and Commission approval. Audit Report at 23-28. While the Trade Associations could understand such criticisms if the funds were somehow misspent or unaccounted for, no such allegations have been made.

For its part, NERC says that "in order for the organization to function on an ongoing basis, management must have the ability to reallocate unspent budgeted funds from one budget activity to another as needs require, or to new activities that were not anticipated in the business plan and budget but must, based on changing circumstances, conditions and requirements, be initiated during the year." NERC Brief at 20. Again, the Trade Associations sympathize with NERC's position. Even when they prepare their own budgets for each calendar year the prior fall, the Trade Associations find that during the course of a budget year, funds must be spent on new initiatives that take advantage of opportunities or respond to emerging developments that were not known or fully understood when the budget was prepared and approved. Similarly, some anticipated activities do not pan out, or require less money than anticipated. So long as an overall increase in the budget is not required, and the relevant bodies (*e.g.*, boards and

committees) are kept apprised at regular intervals of the disbursements and revenues, actual formal mid-year revisions to budget line items are generally not made.

As NERC points out (*id.* at 18-21), its budget cycle is even more protracted than that of other organizations, due to the very public nature of the process and the need for Commission approval of its budgets. Hence, it is, as NERC notes, “impossible to accurately identify, 18 or more months in advance, all specific activities and costs that will be required to carry out NERC’s responsibilities as the ERO over the course of the budget year.” *Id.* at 20. NERC prepares quarterly budget-to-actual cost variance reports for its Finance and Audit Committee, which are posted on the website and discussed in meetings and conference calls that are open to stakeholders and Commission representatives. *Id.* at 23. Finally, NERC also makes an annual actual cost-to-budget reconciliation filing. *Id.* at 23-24. Hence, there is sufficient transparency for stakeholders and the Commission to see how NERC’s funds are being spent, and what deviations have been made from previously developed budgets.

NERC has acceded to certain of the recommendations of the Commission’s staff in this area, and offered accommodations on certain others. *Id.* at 27-28. The Trade Associations believe that the compromise NERC has offered in this subject matter area is sufficient and should be accepted by the Commission. NERC must retain flexibility during the course of a budget year to redirect funds as management deems necessary to carry out NERC’s ongoing functions. Further, ongoing oversight is the responsibility of the NERC Board of Trustees, subject to regulatory oversight by the Commission and Canadian provincial authorities through review and approval of the NERC Business Plan and Budget.

**III.**

**CONCLUSION**

The Trade Associations request the Commission to consider the points made in this Brief when considering and resolving the issues raised in the Audit Report.

Respectfully submitted,

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August 20, 2012

## **CERTIFICATE OF SERVICE**

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010, I hereby certify that I have on this day served the foregoing document by electronic or other means upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 20th day of August, 2012.

By /s/ Susan N. Kelly

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