

MEMORANDUM

TO: Holly Mann, Secretary
NERC Member Representatives Committee

FROM: Tim J. Arlt
John DiStasio
Bill Gallagher
John Twitty

DATE: January 31, 2013

SUBJECT: Response to Request for Policy Input

The MRC's State and Municipal and Transmission Dependent Utility Sectors ("SM-TDUs") appreciate the opportunity to respond to the January 10, 2013 letter from NERC Board Chair John Q. Anderson to Ms. Carol Chinn, Chair-Elect of the NERC Member Representatives Committee ("MRC"), requesting policy input on topics to be discussed by the NERC MRC and the NERC Board of Trustees at the upcoming February 2013 meetings.

This response addresses each of the five topics raised in Mr. Anderson's letter: Standards Reform, Communications Protocols, the Reliability Assurance Initiative, NERC's Three-Year Strategic Plan and implementation of the Bulk Electric System Definition.

At the outset, each of us would like to express our heartfelt thanks to John Q. Anderson for his many years of service and leadership as a Trustee for the North American Electric Reliability Corporation, and for the last four years, as Chair of the Board of Trustees. His leadership, wise counsel and open-mindedness to the perspectives of all of NERC's many diverse stakeholders and governmental authorities have proved instrumental to every aspect of NERC's transition from a voluntary council of industry participants and regional organizations to an independent electric reliability organization charged by Congress and Canadian provincial authorities with ensuring the reliable operation and planning of the bulk power system in North America. Among other things, his tenure as Chair has seen a vastly improved relationship among NERC, FERC and stakeholders; a shifting focus from mere compliance to reliability and performance-based standards; and an overall more businesslike approach to the affairs of NERC. He has led NERC with calm, patience, superb judgment and humor, through innumerable trials large and small. He has our deep thanks.

I. Standards Reform

The SM-TDUs fully endorsed the standards policy resolution that was approved by the Board of Trustees at its November 2012 meeting. Many reform efforts are now underway or nearing completion, including the restructuring of NERC leadership and staff for standards development, implementation of the recommendations from the Standards Process Input Group, approval and initiation of the Reliability Issues Steering Committee, approval of revisions to the Standard Processes Manual, completion of a new Standards Committee strategic work plan and charter, and

development of the 2013-2017 Reliability Standards Development Plan. All of these efforts should all be allowed to move to implementation without further changes in policy direction, scope or governance beyond those presented for Board approval this February.

Our reasons for this stance are practical: the Board, NERC management and stakeholders devoted substantial resources to launching each of the initiatives outlined in your letter. Now it is time to allow the NERC standards program, the Standards Committee and the Reliability Issues Steering Committee to develop the new processes that are needed to actually carry out this change in direction. For example, ensuring that all new or revised standards are technically sound, clear and results-based is not a simple task, in light of the many standards projects that are already under development. The SC's Strategic Work Plan and 2013-2017 Reliability Standards Development Plan each adopt challenging goals for 2013 and 2014. SM-TDUs emphasize that the Paragraph 81 initiative to retire redundant or unnecessary reliability standards must not be allowed to falter or lose momentum.

SM-TDUs also support adoption of the RISC's recommendations at BOT Agenda Item 12, page 24:

The RISC recommends that the Board adopt [the RISC's proposed] strategic prioritization and endorse the RISC's continued work on a gap analysis on the high-priority and then the medium-priority issues.

In addition, the RISC recommends that the Board direct NERC to incorporate these priority rankings into the development of ERO business plans, and direct NERC Committees to incorporate these priority rankings into the development of their plans – including empowering committees to stop or defer lower priority work.

We further suggest that the RISC be directed to work with NERC staff and Standing Committee leadership to create a results-driven Reliability Strategy development process that integrates with budget development and overall ERO planning (e.g., Standing Committee planning, department and employee goal setting).

We recommend that NERC incorporate the RISC's strategic prioritization effort into *all* of NERC's programs, not merely the standards program. However, this process should take place during planning for the 2014-2016 Business Plan and Budget process rather than as mid-course corrections to the current-year plan.

II. Communication Protocols

SM-TDUs continue to support the approach to “three-part” communication as required in approved standard COM-002 and proposed in draft standard COM-003. COM-002 requires the use of three-part communications during emergencies and in response to conditions that may lead to an Adverse Reliability Impact. In contrast, draft COM-003 adopts a programmatic approach to compliance that emphasizes registered entity self-identification and correction of performance deficiencies. This approach properly focuses utility operators on learning to use three-part communications for operating instructions during normal operations, thereby ensuring that clear and effective three-part communications are used during pre-emergency and emergency conditions.

However, most verbal communications between System Operators entail the exchange of routine operating condition information, not “operating instructions” to change the configuration of the BES. These routine information exchanges do not need to take place through three-part communication protocols to ensure that operators carry out their responsibilities. Put another way, it makes sense to require operators to use three-part communications during emergencies. It makes sense to train operators to use three-part communications for operating instructions issued during normal operations. However, it is not appropriate for a NERC standard to require operators to use three-part communications for routine communications under normal operating conditions or for the standard to require registered entities to document all of their routine operating communications. Doing so will create additional work without any benefit to the reliability of the Bulk Power System.

Industry stakeholders remain concerned with how proposed COM-003 will be enforced. SM-TDUs suggest that all CEOs work with their companies, sectors, NERC management and Regional Entities to obtain agreement on an acceptable set of communications standards and associated compliance elements, including Reliability Standard Audit Worksheets. SM-TDUs seek greater clarity on how NERC and Regional Entities will assess the quality and implementation of an entity’s internal controls.

III. Reliability Assurance Initiative

SM-TDU's fully support the January 30, 2013 Joint Trade Association Policy Input on the Reliability Assurance Initiative (“RAI”).¹ We will not repeat or summarize the Joint Trade Association Policy Input here, but do reiterate two points we have made on many occasions before: on behalf of our state-municipal and transmission dependent utility sector members, we urge NERC and the Board of Trustees to afford the RAI its highest priority. We also urge NERC to push ahead on the transition of Find, Fix and Track to its next stage: Find, Fix and Record. No other set of NERC initiatives have a greater potential to free up NERC, regional and industry resources for better uses than a more effective, risk-based compliance program.

IV. Three-Year Strategic Plan

SM-TDUs generally support the NERC Three-Year Strategic Plan for 2013-2015 and pledge to work with NERC to establish achievable, measurable ERO and RE goals and performance metrics for the plan. This goal and performance metric development process will be critically important to the success of the 2014 NERC Business Plan and Budget process that is now being initiated. As an initial matter, the Strategic Plan should be mapped against NERC’s current program activities as well as the criteria for certification as the ERO. Also, the Strategic Plan does not set clear objectives for communication with stakeholders and reliance upon the subject matter expertise of industry through standard drafting teams and NERC’s extensive committee structure. As a

¹ Joint Trade Association Response to January 10, 2013 Request for Policy Input from NERC Board Chairman John Q. Anderson on the Reliability Assurance Initiative (RAI). The Joint Trade Associations include the American Public Power Association, Edison Electric Institute, Electric Power Supply Association, Electricity Consumers Resource Council, the Large Public Power Council, National Rural Electric Cooperative Association and Transmission Access Policy Study Group.

related matter, SM-TDUs support the revised Section 215 Budget Criteria that were presented to the Board for approval during its January 30, 2013 meeting by conference call.

V. Bulk Electric System Definition

SM-TDUs continue to support FERC approval of the Phase One BES Definition as filed by NERC in January 2012, while recognizing that Commission Order No. 773 directed several changes in how NERC interprets the filed definition. The American Public Power Association, the Transmission Access Policy Study Group and other groups each sought rehearing of the Commission's final rule on a number of grounds. SM-TDUs are both surprised and disappointed that NERC did not take issue with the Commission's determination that it could lawfully direct NERC to interpret the BES Definition in ways that are clearly inconsistent with the plain meaning of the Definition, without remanding the Definition to NERC. Nonetheless, SM-TDUs recognize that unless a stay of effectiveness is issued by the Commission, many of our members may be forced to submit detailed exception requests to NERC, seeking clarity as to whether their distribution facilities are now deemed to be BES facilities. Other members may be forced to seek determinations directly from FERC that their facilities are "used in local distribution."

SM-TDUs also support efforts by the BES Drafting Team to complete and post a revised Guidance Document to assist industry stakeholders in the implementation of the BES Definition, as well as completion of Phase 2 of the BES Definition project.

Thank you for the opportunity to provide this input.

MEMORANDUM

TO: Holly Mann, Secretary
NERC Member Representatives Committee

FROM: Allen Mosher, Vice President, Policy Analysis & Reliability Standards,
American Public Power Association
Bill Gaines, Director of Utilities and CEO, Tacoma Utilities, on behalf of
the Large Public Power Council
John Twitty, Executive Director, Transmission Access Policy Study
Group

DATE: January 31, 2013

SUBJECT: Response to Request for Policy Input

The American Public Power Association, the Large Public Power Council, and the Transmission Access Policy Study Group have reviewed and concur in the response submitted today by the State/Municipal and Transmission Dependent Utility Sectors to NERC Board Chair John Q. Anderson's January 10, 2013 letter requesting policy input in advance of the February 2013 NERC Board of Trustees meeting.

In addition, the American Public Power Association, the Large Public Power Council, and the Transmission Access Policy Study Group are sponsors of the Joint Trade Association Policy Input on the Reliability Assurance Initiative, dated January 30, 2013.





**Joint Trade Association Response to January 10, 2013
Request for Policy Input from NERC Board Chairman John Q. Anderson
on the Reliability Assurance Initiative (RAI)**

January 30, 2013

The Trade Associations¹ support the conclusion drawn in NERC Staff's conceptual White Paper that

[i]t is not practical, effective or sustainable for the ERO Enterprise and Registered Entities to monitor and control all compliance to the same degree. Further, it is not practical, effective, nor sustainable for the ERO Enterprise and Registered Entities to treat all findings and discrepancies, as violations triggering the same degree of enforcement and evidentiary documentation. Where a violation does not pose a serious or higher risk to the reliability of the bulk power system, and the Registered Entity has a compliance program and internal controls that detect, assess, mitigates and self-reports the violation, the Regional Entity may decline to pursue an enforcement action.²

The Trade Associations further support the aims articulated in NERC's "Change State Element Paper No. 1 (Restyle the Compliance Monitoring Approach)" that:

¹ This response is supported jointly by American Public Power Association, Edison Electric Institute, Electric Power Supply Association, ELCON, the Large Public Power Council, National Rural Electric Cooperative Association and Transmission Access Policy Study Group.

² http://www.nerc.com/files/Reliability_Assurance_Initiative_Risk_Concepts_White_Paper.pdf, at p. 2.

- "...the compliance monitoring approach will be restyled to be more explicitly shaped around the risk to reliability;"³ and
- "Audits should be scoped to address the potential risk the entity poses to the BPS and the potential risk to comply with established reliability standards."⁴

While the Trade Associations appreciate the effort NERC staff has undertaken to elicit our input on the RAI, there is serious concern with steps taken, to date, to develop and implement the program. These concerns center on: (1) the potential for NERC's focus on the development of the RAI program to interfere with maturation of the Find-Fix-Track ("FFT") program; (2) the lack of clear direction governing registered entity and regional entity responsibilities; (3) the need for a realistic plan for developing and implementing the program, including the management of any necessary filings with FERC; and (4) the need for each regional entity to demonstrate their commitment to implement both programs in a timely and consistent manner. These issues are addressed below.

(1) Relationship to FFT

With its initial filing in support of the FFT program, NERC indicated that in a second implementation phase, it would work with its compliance and enforcement staff to authorize compliance field staff, auditors and investigators to make determinations regarding violations eligible for FFT treatment. In conditionally accepting NERC's initial September 2011 FFT proposal, FERC commented favorably on this second phase, paraphrasing NERC's proposed approach as follows:

NERC explains that, in Phase II, both compliance staff and enforcement staff would determine the ultimate disposition of possible violations. NERC proposes that compliance field staff, auditors and investigators make such determinations in the course of compliance audits, spot checks and compliance investigations, and that there will be constant collaboration with NERC and Regional Entity enforcement staff.⁵

The Commission permitted NERC to move ahead with this phase of the program, subject to the submission of further information regarding necessary training programs and procedures assuring coordination between compliance and enforcement personnel, and protocols ensuring consistent outcomes.⁶

³<http://www.nerc.com/files/RAI%20Change%20State%20Element%20No%201%20-%20Restyle%20the%20Compliance%20Monitoring.pdf>, at p. 2.

⁴ *Id.*, at p. 9.

⁵ 138 FERC ¶ 61,193 at P 24 (2012) (the "March 15 Order").

⁶ *Id.* at PP 79-80.

The Trade Associations strongly encourage NERC, with the commitment and support of the regional entities, to move ahead with this second phase of the FFT program at this time, independent of its schedule for developing and implementing the RAI program. While the Trade Associations recognize some overlapping effort between the RAI and FFT initiatives with respect to training for compliance personnel, the Associations urge NERC to seize the opportunity that the March 15 Order presents now. Though the Trade Associations are hopeful that NERC will make progress in developing and ultimately implementing the RAI, the effort is undeniably complicated and may require some additional regulatory approval or acquiescence. With the regulatory hurdles for the second phase of the FFT program having been cleared, it would be a misjudgment to forego the immediate opportunity for further progress. Furthermore, additional success with respect to the second phase of the FFT effort may very well smooth the way for the incremental RAI effort.

(2) The Need for Clarity Regarding Registered Entity and Regional Entity Responsibilities Under the RAI

The Trade Associations are concerned that insufficient attention has been paid, to date, to the development of a clear statement of the impact the program will have on registered entities (including the identification of reliability benefits and cost savings), and the expectations of, and responsibilities imposed upon, registered entities. Our understanding is that the RAI will be designed to scale compliance oversight to the risk profile presented by a registered entity, and that such risk will be ascertained as a function of the strength of each entity's compliance program (including internal controls) and physical circumstances. Central questions regarding how registered entities will address these new criteria have yet to be answered, including: (1) how internal controls are defined and evaluated; (2) whether internal controls are relevant to all, or only a subset of, the reliability standards; (3) whether and how the criteria for evaluation of internal controls will vary based on the size of the registered entity; (4) how registered entities will document their internal controls and compliance programs; (5) how registered entities will document and represent their views of the physical risk profiles they present; (6) what role self-reports will have in the new regime; (7) how the RAI will manage the evaluation of entities whose business units span multiple regions; and (8) how NERC will oversee regional programs.

As well, the RAI documentation, to date, contains little information regarding the standards or protocols by which regional enforcement entities will evaluate registered entities under the RAI, and how those evaluations will factor into determinations regarding compliance oversight. Criteria for such evaluations, and their effect on compliance oversight should be clearly understood and the evaluations predictable, in order to ensure a degree of consistency between entities and among regions, and assure registered entities that the program is being administered fairly.

The Trade Associations have provided NERC Staff with outlines for two additional papers, addressed to the broad questions outlined above, to supplement development of the RAI. We ask for a commitment by NERC to work with the Trade Associations and other stakeholders in responding to this input as development of the RAI progresses.

(3) NERC Must Work With a Realistic Plan for Developing and Implementing the RAI.

By letter dated December 6, 2012, the Trade Associations urged NERC to step back from what appeared to be a commitment to file with FERC by March 15, 2013 a proposal to implement the RAI. The Trade Associations expressed general support for the RAI, and appreciation for NERC's interest in considering industry input. However, the Trade Associations were also concerned that a self-imposed deadline for a filing by March 15 would short-circuit NERC's ability to receive and process all necessary input, and potentially undermine critical stakeholder support.

NERC Staff's background material for MRC Agenda Item 6(b) indicates that NERC has tabled the proposed March 15 deadline, responding to the Trade Association input. The Trade Associations appreciate NERC Staff's responsiveness on this point, and reiterate here the importance of not rushing the RAI toward a FERC filing before all needed input can be considered. The Trade Associations are fully prepared to work with NERC and the regions to provide constructive, timely input in order to assist NERC in developing a coherent package around which broad consensus can be reached. Toward that end, the Trade Associations urge NERC Staff to develop and adhere to a realistic plan for bringing the RAI to fruition, incorporating a workable schedule for eliciting thoughtful industry input, and outreach to FERC. An effective management plan for the RAI would describe the steps to be taken, timelines, and the sequence of activities. The plan would foster management discipline and accountability, provide transparency, and allow all parties to schedule their work efforts against multiple work tasks competing for limited time. As well, careful consideration must be given to determining which elements of the RAI, if any, call for FERC approval.

The Trade Associations also encourage NERC to consider the merit of moving ahead with the RAI in phases, perhaps through the consideration and analysis of pilot programs undertaken voluntarily, while permanent protocols are ironed out. The RAI is an ambitious program, calling for substantial coordination with the regional entities, reworking of existing compliance programs and training at all levels. Considering the program in phases may enable NERC, the regions and the industry to more carefully consider and accommodate this change in the compliance paradigm, if implemented pursuant to a concrete and realistic plan.

Above all, the Trade Associations urge NERC, following deliberate consideration, to place a priority on letting the compliance and enforcement program settle into a durable and repeatable set of processes and activities. While NERC's history of experimentation in the compliance and enforcement space reflects a healthy interest in innovation, it is important to recognize that there is a limit to the industry's and FERC's ability to process endless changes in these programs. With each innovation, NERC calls for the industry to reorganize its compliance efforts, with significant costs and inevitable inefficiencies. The costs include not only direct time and expenditures on personnel, but adverse reliability risks associated with continuous changes in process. NERC is nearing the point where it must get these programs right, and give the industry time to settle into managing a mature program.

(4) The Need for Regional Entity Commitment to Implementation of the FFT and RAI Programs.

Since the establishment of the ERO, stakeholders have made consistent implementation of compliance and enforcement programs by all of the regional entities a priority. As the FFT program has developed, there has been concern that not all the regional entities are equally committed to its full implementation. As we move forward with the next phases of FFT and the development and implementation of the RAI, it is essential that all regional entities demonstrate their commitment to the goals and consistent implementation of these programs.