

White Paper

Mandatory Reliability Standards and FERC Enforcement Procedures: A Roadmap for Registered Entities

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On a hot summer's day in 2003, a handful of power lines in Ohio tripped after making contact with overgrown trees.² Over the next 13 minutes, the bulk power system³ experienced cascading failures that left an estimated 50 million people in the United States and Canada without power.⁴ After investigating the blackout, a joint United States-Canadian government task force recommended the adoption of mandatory reliability standards, with substantial penalties for noncompliance.⁵ The next year, Congress passed the Energy Policy Act of 2005 ("EPAAct 2005").⁶ EPAAct 2005 added Section 215 ("Section 215") to the Federal Power Act (FPA),⁷ giving the Federal Energy Regulatory Commission (FERC or the "Commission") jurisdiction over the establishment and enforcement of mandatory reliability standards.

This article generally describes the implementation of Section 215, including the types of reliability standard violations most likely to trigger enforcement actions in 2014 and the evolving procedures for investigating and prosecuting possible violations. We also discuss the consequences of noncompliance, including the possibility of significant penalties.⁸ We then explain the importance of comprehensive compliance planning and the benefits of self-reporting when violations or potential violations are discovered.

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² See generally, U.S.-Canada Power System Outage Task Force, Final Report on the August 14, 2003, Blackout in the United States and Canada: Causes and Recommendations (April 2004) ("Task Force Report"), available at <http://certs.lbl.gov/pdf/blackoutfinal-web.pdf>.

³ The bulk power system (BPS) refers generally to the wholesale power grid within the scope of FERC's jurisdiction. The bulk electric system (BES) is that portion of the bulk power system to which the reliability standards apply. See Memorandum from NERC Standards Committee to NERC Legal Standards Departments (Apr. 12, 2012), http://www.nerc.com/files/Final_BES_vs%20BPS_Memo_20120410.pdf. The BES, as formally defined, generally includes all facilities at or above 100 kV, subject to certain inclusion and exclusion provisions. See *Revisions to Electric Reliability Organization Definition of Bulk Electric System and Rules of Procedure*, 141 FERC ¶ 61,236 (2012), order on rehearing, 143 FERC ¶ 61,053 (2013). Although the BES is largely coextensive with the electric transmission system, the two are not synonymous. For example, high-voltage radial generator lead lines, despite being subject to FERC jurisdiction, are not generally thought of as "transmission," but are subject to the reliability standards. Likewise, not all facilities under FERC jurisdiction (and thus part of the BPS) are part of the BES. See *North Am. Elec. Reliability Corp.*, NERC Full Notice of Penalty regarding Milford Wind Corridor Phase I, LLC, filed June 27, 2013, Docket No. NP13-40-000; North American Electric Reliability Corp., Notice, issued July 26, 2013, Docket No. NP13-40-000.

⁴ Task Force Report at 1.

⁵ *Id.* at 140.

⁶ Energy Policy Act of 2005, Pub. L. 109-058.

⁷ 16 U.S.C. § 824o (2006).

⁸ See e.g., *Florida Blackout*, 129 FERC ¶ 61,016 (2009) (\$25 million penalty, but \$5 million was remitted to the registered entity for reliability improvements).

EXECUTIVE SUMMARY

FERC certified the North American Electric Reliability Corporation (NERC) as the Electric Reliability Organization for the United States,⁹ giving it responsibility for developing and enforcing the reliability standards.¹⁰ NERC continues to work toward its “end-state vision” for compliance and enforcement. This envisioned end state is risk-based, with increased incentives for registered entities to have robust compliance programs. Entities with strong compliance programs may be able to take primary responsibility for the detection, remediation and reporting of lower-risk violations, subject to oversight and abbreviated enforcement procedures. At the same time, all violations will remain “visible” to NERC and FERC to allow for trend analysis.¹¹ Enforcement resources will be concentrated on violations that pose “serious or substantial” risks to the bulk power system, with certain moderate risk issues being addressed through the Find Fix Track and Report (FFT) mechanism that we describe below.¹² Violations that cause extended outages, loss of load, cascading blackouts, vegetation contacts, systemic or significant performance issues, intentional misconduct and gross negligence will continue to be fully investigated.¹³

NERC also is streamlining the reliability standards themselves. FERC has authorized NERC to retire 34 reliability requirements belonging to 19 different reliability standards.¹⁴ These retired reliability requirements were found to “(1) provide little protection for Bulk-Power System reliability or (2) [be] redundant with other aspects of the Reliability Standards.”¹⁵ FERC had invited NERC to make such a review of the standards, observing that, if many reliability violations involve little risk to the bulk power system, perhaps the standards themselves require revisions.¹⁶ When NERC made its submission suggesting the retirement of certain requirements, all commenters gave their support.¹⁷

For registered entities, these changes are largely beneficial, but pose their own challenges. A risk-based approach will reward entities with robust, proactive compliance programs and penalize those that are less aggressive in policing themselves. Moreover, a NERC compliance program should be a “living document,” being constantly revised and updated to reflect best practices and internal controls. Industry best practices need to be monitored and incorporated on a continuous basis. This is particularly true of security-related issues, since violations of the critical infrastructure protection standards are the most common reliability violations, and these standards are still in the process of change.

⁹ North Am. Elec. Reliability Corp., 116 FERC ¶ 61,062 (2006).

¹⁰ 16 U.S.C. 824o(c).

¹¹ NERC, *RAI Compliance Activities Overview*, BOARD OF TRUSTEES COMPLIANCE COMMITTEE AGENDA 2 (Jan. 6, 2014) (“Compliance Overview”), http://www.nerc.com/gov/bot/BOTCC/Compliance%20Committee%202013/February_5_BOTCC_Open_Package.pdf.

¹² Enforcement Overview 2,4.

¹³ *Id.* at 7. These are the same sorts of violations that are currently addressed through full NOPs.

¹⁴ Electric Reliability Org. Proposal to Retire Requirements in Reliability Standards, 145 FERC ¶ 61,147 (2013) (“Retirement Order”).

¹⁵ *Id.* at P 1.

¹⁶ FFT Order at P 81.

¹⁷ Retirement Order at P 23.

DISCUSSION

I. FERC, NERC and the Regional Entities all Participate in the Monitoring and Enforcement of the Reliability Standards

Pursuant to FPA Section 215, FERC certified NERC as the Electric Reliability Organization for the United States,¹⁸ giving it responsibility for developing and enforcing the reliability standards.¹⁹ In accordance with Section 215, FERC also authorized NERC to delegate NERC's authority to monitor and enforce compliance with the reliability standards to regional entities (REs).²⁰ NERC has entered into delegation agreements with eight REs: Florida Reliability Coordinating Council (FRCC), Midwest Reliability Organization (MRO), Northeast Power Coordinating Council (NPCC), ReliabilityFirst Corporation (RFC), Southwest Power Pool (SPP), SERC Reliability Corporation (SERC), Texas Reliability Entity (TRE), and the Western Electricity Coordinating Council (WECC). NERC and the REs are collectively referred to as the "ERO Enterprise."²¹ The geographic scope of each RE is shown in Figure 1 below:

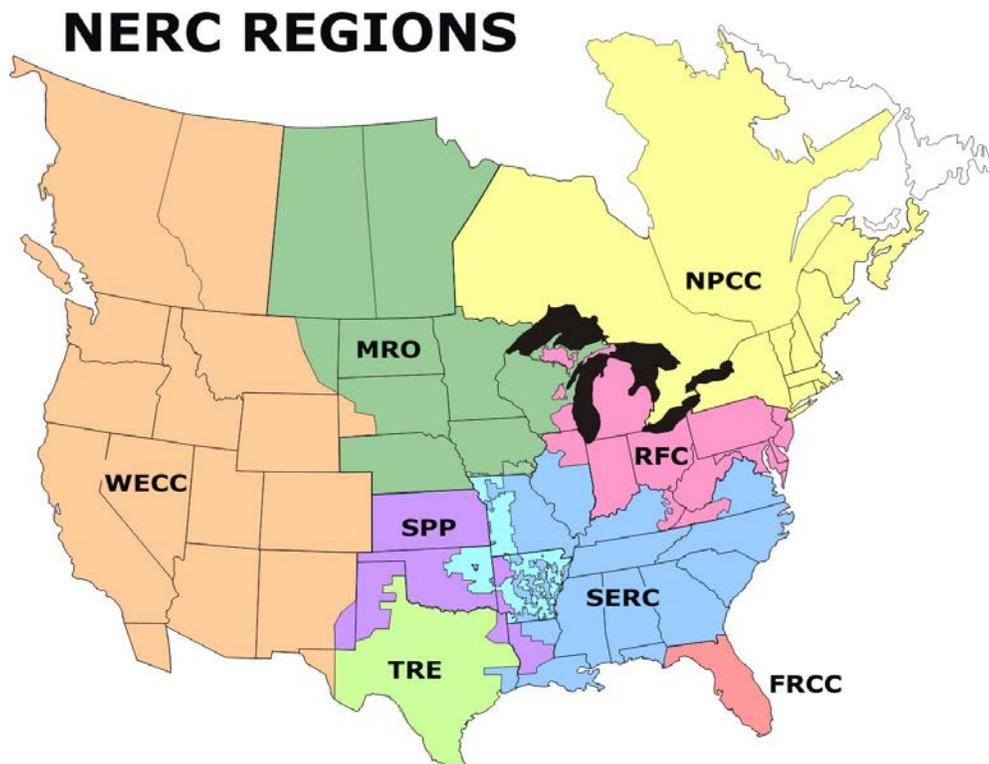


Figure 1: NERC Regions, showing the footprint of the eight REs. From Regional Entities, North American Electric Reliability Corporation, 2013, <http://www.nerc.com/AboutNERC/keyplayers/Pages/Regional-Entities.aspx>.

¹⁸ North Am. Elec. Reliability Corp., 116 FERC ¶ 61,062 (2006).

¹⁹ 16 U.S.C. 824o(c).

²⁰ *Id.* § 824o(e)(4); North Am. Elec. Reliability Corp., 116 FERC ¶ 61,062 (2006).

²¹ "The ERO enterprise is a collaborative, international network comprising the North American Electric Reliability Corporation and the eight Regional Entities that brings together collective leadership, experience, judgment, skills, and technologies for ensuring the reliability of the North American bulk power system." See *Electric Reliability Organization Enterprise Strategic Plan 2013-2016*, NERC 1 (2013), <http://www.nerc.com/gov/bot/FINANCE/Documents/ERO%20Enterprise%20Strategic%20Plan%202013-2016%20FINAL%2005%2009%2013.pdf>.

The REs have the primary responsibility for compliance monitoring, and most, but not all, enforcement actions are initiated by the relevant RE. NERC also engages in monitoring and enforcement activities directly. An RE decision may be appealed to NERC (and NERC must ultimately approve RE dispositions of reliability violations), and NERC's decisions are reviewed by FERC.²² Therefore, a reliability enforcement action can involve proceedings before three separate enforcement agencies, and each of these proceedings is essentially *de novo*.²³ The guarantor (which includes both entities and individuals) commits to the creditor in writing that the guarantor is legally bound to perform the obligations of payment pursuant to the guarantee agreement; and FERC has independent authority to enforce the reliability standards.²⁴ However, FERC has initiated relatively few reliability enforcement proceedings to date, and all of these have ended in a settlement.²⁵

II. NERC Is Implementing a Risk-Based Approach to Reliability

As of June 18, 2007, when the reliability standards first became mandatory, NERC already had more than 5,000 potential violations to process, the result of entities self-reporting prior to the effective date of FPA Section 215 to avoid enforcement actions.²⁶ By September 2011, NERC had identified an additional 7,500 potential violations, creating a massive backlog.²⁷

The reliability standards originated in the context of voluntary industry self-regulation before FPA Section 215 was passed.²⁸ The standards are numerous, technical and highly detailed. They cover, in

²² 16 U.S.C. § 824o(c).

²³ Statement of Admin. Policy on Processing Reliability Notice of Penalty, 123 FERC ¶ 61,046 at P 9 (2008); NERC Rules of Procedure (ROP) § 409; Energy Bar Association, Discussion Regarding the NERC and Regional Entity Hearing and Appeal Processes, 30 ENERGY L.J. 133, 144 (2009). However, NERC must confine its review to the record comprising the RE and should give "appropriate deference" to the RE's determinations of fact in specific cases where the RE's role as reliability manager and its familiarity with operating conditions would so warrant. See North Am. Elec. Reliability Corp. 116 FERC ¶ 61,062 at P 491 (2006).

²⁴ 16 U.S.C. 824o(e)(3). FERC is most likely to involve itself in violations that resulted in "actual harm, either through the loss of load or through some other means," violations that carried "a substantial actual risk to the system," and violations that involved repeat offenders. *Reliability and Enforcement*, FERC, <http://www.ferc.gov/enforcement/reliability.asp> (last updated July 22, 2013). For a detailed discussion of FERC enforcement and penalty procedures, see Suedeek Kelly and Julia E. Sullivan, *Navigating the FERC Enforcement Process*, INSIDE THE MINDS: COMPLYING WITH ENERGY AND NATURAL RESOURCES REGULATIONS 7 (Thompson Reuters/Aspatore 2014) (Although this chapter discusses FERC enforcement in the market manipulation context, essentially the same procedures are used for reliability investigations).

²⁵ *Southwest Power Pool, Inc.*, 144 FERC ¶ 61,019 (2013) (\$50,000 penalty); *Entergy Services, Inc.*, 142 FERC ¶ 61,241 (2013) (\$975,000 penalty); *California Independent System Operator Corp.*, 141 FERC ¶ 61,209 (2012) (\$200,000 penalty); *PacifiCorp*, 137 FERC ¶ 61,176 (2011) (\$3,925,000 penalty); *Grand River Dam Authority*, 136 FERC ¶ 61,132 (2011) (\$350,000 penalty); *Western Electricity Coordinating Council*, 136 FERC ¶ 61,020 (2011) (\$350,000 penalty); *Florida Blackout*, 130 FERC ¶ 61,163 (2010) (\$350,000 penalty); *Florida Blackout*, 129 FERC ¶ 61,016 (2009) (\$25 million penalty, but \$5 million was remitted to the registered entity for reliability improvements). The penalties assessed by FERC, even in settlement proceedings, are, on average, much higher than those assessed by NERC and the REs.

²⁶ *North Am. Elec. Reliability Corp.*, Petition Requesting Approval of New Enforcement Mechanisms at 6, filed Sept. 30, 2011, Docket No. RC11-6-000 ("FFT Petition").

²⁷ *Id.* at 7.

²⁸ See generally, *History of NERC*, NERC (Aug. 2013), <http://www.nerc.com/AboutNERC/Documents/History%20AUG13.pdf>; *Version 0 Reliability Standards*, NERC, <http://www.nerc.com/pa/Stand/Pages/Version-0.aspx> (last visited Feb. 19, 2014); FERC Reliability Team Analysis, *Transitioning from Existing NERC Operating Policies and Planning Standards to the American National Standards Institute (ANSI) Version 0 Reliability Standards*, FERC (May 14, 2004), <https://www.ferc.gov/EventCalendar/Files/20040517094115-staff-reliability.pdf>; Mandatory Reliability Standards for the Bulk-Power System, 117 FERC ¶61,084 at PP 1-24 (2006).

addition to major threats to system stability, a vast swathe of conduct that ordinarily poses little risk to the reliability or stability of the bulk power system. As FERC Commissioner Cheryl LaFleur²⁹ observed in 2010, “if everything is a priority, then nothing is a priority.”³⁰ Significant public and private resources were invested, in some cases, to resolve minor violations. NERC provided the following example in a September 2011 FERC filing:

A small entity failed to have on file and available to its staff a record of the local FBI office to aid in reporting possible sabotage events, a violation of CIP-001 Requirement (R) 4. The resulting [Notice of Penalty (“NOP”)] and supporting material for this single issue violation was over 40 pages long and took 21.5 months to process from discovery to the filing of the NOP.³¹

Considering that contact information for the local FBI office likely could be located on the Internet, this seems like overkill.

The ERO enterprise (*i.e.* NERC and the REs) initiated a multiyear program, the Reliability Assurance Initiative (RAI), to better focus monitoring and enforcement programs on violations that pose significant risks to system reliability and stability and to reduce the administrative burden on registered entities.³² As discussed below, the RAI has resulted in significant changes to the ERO enterprise’s monitoring and enforcement operations.

III. NERC Establishes Compliance Priorities Annually

Each year, NERC develops an implementation plan that includes an Actively Monitored List (“AML”) of reliability standards. The AML identifies the ERO enterprise’s enforcement and monitoring priorities for the upcoming calendar year.³³ It includes those standards (and specific requirements within standards) that NERC’s formal risk assessment procedures have identified as addressing significant risks to the bulk power system, and highlights those standards and requirements for audits and/or self-certification procedures.³⁴ Registered entities remain responsible for compliance with all applicable reliability standards, not only those on the AML.³⁵

On or around September 1 of each year, NERC provides its implementation plan to the REs, along with a template for each RE to create a regional implementation plan. The REs return their regional implementation plans to NERC on or around October 1 for approval.³⁶ In addition to the standards targeted for audit and self-certification, regional implementation plans also indicate what standards will

²⁹ Now Acting FERC Chairman.

³⁰ Statement of Commissioner Cheryl A. LaFleur on NERC’s Three-Year Assessment, Docket Nos. RR09-7-000 and AD10-14-000 (Sept 16, 2010).

³¹ FFT Petition at 10.

³² *ERO Compliance Monitoring and Enforcement Program, 2014 Implementation Plan*, NERC 6-7 (revised Nov. 1, 2013) (“2014 Implementation Plan”), [http://www.nerc.com/pa/comp/Resources/ResourcesDL/2014%20ERO%20CMEP%20IP%20v%201%20\(11-01-13\)%20Final.pdf](http://www.nerc.com/pa/comp/Resources/ResourcesDL/2014%20ERO%20CMEP%20IP%20v%201%20(11-01-13)%20Final.pdf); *Reliability Assurance Initiative*, NERC, <http://www.nerc.com/pa/comp/Pages/Reliability-Assurance-Initiative.aspx> (last visited Feb. 19, 2014).

³³ As of 2014, NERC ceased dividing the AML into three tiers of increasing concern.

³⁴ Standards that require periodic data submittals are not included on the AML. 2014 Implementation Plan at 13.

³⁵ See NERC ROP, Appendix 4C § 3.1.

³⁶ 2014 Implementation Plan at 6-8.

require data submittals or are likely to be monitored via spot checks. The regional implementation plans also list the entities scheduled for an audit by the RE in the upcoming calendar year. The approved regional implementation plans are appended to the NERC implementation plan to create the final implementation plan document for the upcoming calendar year.

For 2014, the AML identified 24 standards for audit and 52 standards for self-certification,³⁷ representing a 75 percent reduction in audit scope and a 55 percent reduction in self-certification scope compared with 2013.³⁸ This reduction in scope is a result of the RAI program's focus on risk-assessment. Standards were selected because they were implicated in outages or were the subject of compliance investigations, such as those governing emergency operations during capacity or energy shortages,³⁹ vegetation management,⁴⁰ load shedding,⁴¹ system restoration from blackstart,⁴² maintenance and testing of "protection systems"⁴³ and transmission operations.⁴⁴ Additional standards were identified for the AML based on risk analysis, including one requiring that operating personnel have the latitude to take real-time actions to ensure stable and reliable operation.⁴⁵

Most of the Critical Infrastructure Protection (CIP) requirements, which cover both cyber- and physical security, also are included on the AML. The CIP standards, now on Version 5, have been revised several times and are in the process of being modified again. The CIP standards account for 60 percent of reliability violations,⁴⁶ in part because of the difficulties registered entities have faced in achieving "zero defect" compliance due to the complexity of and inherent ambiguities in security.⁴⁷ Recent events, including a sniper attack on a California substation and increasing cyber intrusions, will keep the CIP standards on the AML for the foreseeable future and may result in further revisions.

NERC also highlighted two high-risk issues in the 2014 Implementation Plan for evaluation and consideration by the REs. These issues are protection system mis-operations and AC substation equipment failures. Although NERC did not add standards related to these issues to the AML, it noted that REs might want to engage in increased compliance monitoring.⁴⁸

³⁷ 2014 NERC Actively Monitored List, Tab Summary (last updated Jan. 15, 2014). The current AML can be found on NERC's website in Excel Spreadsheet form. <http://www.nerc.com/pa/comp/Resources/Pages/default.aspx>.

³⁸ 2014 NERC Actively Monitored List, Tab Chart 1.

³⁹ 2014 Implementation Plan 13-19; EOP-002-3.1.

⁴⁰ FAC-003-1.

⁴¹ EOP-003-2; TOP-008-1.

⁴² EOP-005-2.

⁴³ I.e., protective relays, associated communication systems, voltage and current sensing devices, station batteries and DC control circuitry. PRC-005-1b.

⁴⁴ TOP-001-1a, TOP-002-2.1b, TOP-0004-2, TOP-008-1.

⁴⁵ PER-001-0.2.

⁴⁶ 2014 Implementation Plan at 17-18.

⁴⁷ See generally, *Version 5 Critical Infrastructure Protection Reliability Standards*, 145 FERC ¶ 61,160 (2013).

⁴⁸ 2014 Implementation Plan at 17.

IV. Compliance Is Vigorously Monitored⁴⁹

Compliance monitoring is central to NERC's mandate. The NERC Rules of Procedure (ROP) set out seven procedures for detecting reliability violations: (1) compliance audits, (2) self-certifications, (3) complaints and referrals, (4) investigations, (5) spot checks, (6) periodic reports and (7) self-reporting.⁵⁰ Each reliability standard specifies which of these methods may be used to determine compliance with its requirements.

A. Compliance Audits

Each RE's regional implementation plan includes an annual audit schedule,⁵¹ although any registered entity may be subject to an unscheduled audit.⁵² Currently, compliance audits for entities registered as balancing authorities, reliability coordinators and transmission operators are conducted on a triennial schedule,⁵³ and most other entities are audited on six-year cycles.⁵⁴ However, NERC recently changed its rules to allow REs to monitor entities registered as purchasing-selling entities (loosely, power marketers) with only spot checks and self-certifications, rather than regularly scheduled audits,⁵⁵ and further changes to the audit process are planned as part of the RAI.

Registered entities subject to a scheduled audit must be notified prior to October 1 of the year before the audit will be conducted,⁵⁶ and changes to the audit schedule must be communicated in a timely manner (usually 60 days in advance).⁵⁷ A registered entity scheduled for an audit may request a change in the audit schedule for reasonable cause.⁵⁸ A reliability audit will cover the entire period from the end of the prior audit until a specified date, usually the date the entity was notified of the audit or 30 days after such notification.

At least 90 days prior to the commencement of a scheduled audit, the RE will inform the registered entity of the reliability standards to be audited.⁵⁹ An audit will generally cover standards identified in the AML and the regional implementation plan that are applicable to the registered entity.⁶⁰ However, REs often

⁴⁹ For the sake of simplicity, this discussion of NERC's procedures assumes that the RE is the primary authority engaging in monitoring and enforcement. This is usually the case, but NERC and FERC can engage directly in monitoring and enforcement, and this can streamline the enforcement process.

⁵⁰ An eighth method, exception reporting, is embedded within NERC's general discovery procedures. 2014 Implementation Plan at 10.

⁵¹ *Id.* at 6.

⁵² NERC ROP, Appendix 4C § 3.1.3. The ROP allows unscheduled audits to be held with as little as 10 days' notice.

⁵³ NERC ROP § 403.11.

⁵⁴ 2014 Implementation Plan at 23.

⁵⁵ *Id.* Only one reliability requirement is included on the AML for audit or self-certification by purchasing-selling entities. 2014 NERC Actively Monitored List, Tab Requirements Detail.

⁵⁶ *Id.* § 3.1.2 (2013). A list of entities to be audited in the upcoming year is now included in the regional implementation plans.

⁵⁷ *Id.*

⁵⁸ NERC ROP, Appendix 4C § 3.1.2.

⁵⁹ *Id.* § 3.1.1; see also *Compliance Process Bulletin #2011-002, Timing of Audit Notifications*, NERC (June 17, 2011), <http://www.nerc.com/pa/comp/Resources/ResourcesDL/Bulletin%202011-002%20Timing%20of%20Audit%20Notifications.pdf>.

⁶⁰ NERC's Reliability Functional Model is a framework for the reliability standards that describe the roles that need to be filled to protect the reliability of the BPS. Each role or "function" is responsible for certain reliability standards and is filled by a "Functional Entity." Registered entities register to be one or more types of a Functional Entity. See

choose, for any given audit, to audit only the relevant CIP standards or Operations and Planning standards.⁶¹ An audit may include other reliability standards as well, based on an assessment of risks specific to the registered entity, the results of prior audits and standards that were included in prior AMLs.⁶² The RE also may choose to audit mitigation activities that the registered entity has committed to perform because of previous reliability standard violations.

At any time up to the close of the audit, the RE may choose to expand the audit scope to include more standards.⁶³ A decision to include more standards in the audit scope may result either in lengthening the current audit or in a follow-up spot check covering the additional standards. Currently, each RE has its own procedures for determining the scope of an audit,⁶⁴ but NERC is adopting standardized scoping methods as part of the RAI.

The audit team may include staff (including retained contractors and experts) from the RE, NERC and/or FERC, and staff from any of these organizations may accompany the audit team as observers, as may staff members from other REs. Members of the audit team must pass a conflicts check and sign confidentiality agreements (or sign acknowledgments that the RE has signed such agreements). Audits are conducted using professional auditing standards and in accordance with the audit guides published on NERC's website.⁶⁵ An audit will typically take two to three days.⁶⁶

Once the audit is complete, the audit team will develop a draft audit report using the templates available on NERC's website. The draft audit report will identify any potential noncompliance with the reliability standards, as well as any mitigating activities in which the registered entity is currently engaged. The report may provide the recommendations of the audit team and discuss "areas of concern," which are issues that do not currently constitute a violation of the reliability standards, but could result in a violation in the future. The registered entity has an opportunity to comment on the draft audit report, and the audit team will review any comments provided by the registered entity before finalizing the report.

The audit team will prepare public and nonpublic versions of the final audit report.⁶⁷ If the RE's final audit report does not contain findings of noncompliance, NERC will post the public version on its website⁶⁸ and

Reliability Functional Model, Function Definitions and Functional Entities, Version 5, NERC (Nov. 2009), http://www.nerc.com/files/functional_model_v5_final_2009dec1.pdf. Registered entities are responsible for all active reliability standards applicable to the functions for which they are registered, and their compliance with these standards may be monitored by any method permitted by that standard. See NERC ROP, Appendix 4C § 3.1.

⁶¹ However, in many cases, this separation results in two separate audits of the registered entity in a given year, since the RE will audit CIP and Operations and Planning on different occasions.

⁶² See NERC ROP, Appendix 4C § 3.1.4; 2014 Implementation Plan at 20; *Audit FAQs*, TEXAS RELIABILITY ENTITY, <http://www.texasre.org/compliance/audit/faqs/Pages/Default.aspx> (last visited Feb. 19, 2014). TRE, for example, audits entities not only on the current AML, but on the requirements included on AMLs in the past three years.

⁶³ 2014 Implementation Plan at 21. An RE also can decide to reduce the scope of an audit or defer a scheduled audit, but must notify NERC of its intention to do so. NERC reserves the right to deny changes in audit scope or audit deferrals.

⁶⁴ *Id.* at 20.

⁶⁵ NERC ROP, Appendix 4C § 3.1.1.

⁶⁶ See *Audit FAQs*, TEXAS RELIABILITY ENTITY, <http://www.texasre.org/compliance/audit/faqs/Pages/Default.aspx> (last visited Jan. 22, 2014).

⁶⁷ Only nonpublic reports exist for audits of CIP standards. See 2014 Implementation Plan at 22, NERC ROP, Appendix 4C § 3.1.6.

forward the nonpublic version to FERC for review. If the RE's final audit report contains findings of noncompliance, the public version will be not be posted until the enforcement process is completed.

As part of the RAI, the ERO enterprise is taking steps to change its audit procedures to a more standardized, risk-based approach. NERC released a standard auditing checklist that was adopted by the REs in August 2013 and is revising its Reliability Standard Audit Worksheets (RSAWs) so that they are more concise and more accommodating to consideration of an entity's internal compliance controls. NERC has completed, but not publicly released, the first draft of a Compliance Auditor Manual and Handbook ("Auditor Manual"), designed to be a companion to the audit checklist. The Auditor Manual is due to be implemented in mid-2014 and will include standardized processes for risk-based audit scoping and for assessing a company's internal compliance controls. NERC anticipates that the Auditor Manual will be in use for all audits by the end of 2014.

Several REs, with NERC's oversight, also are engaged in pilot programs to test different auditing strategies. The first phase of these pilot programs has been completed, and the results are being evaluated with an eye toward developing "best of class" practices for risk-assessment, scoping, data gathering and testing of internal controls. These best practices will be adopted as ERO enterprise-wide audit policies and will be included in the Auditor Manual and future Implementation Plans.

B. Self-Certifications

A self-certification is an attestation that the registered entity is compliant (or not) with a particular reliability standard or that the standard is not applicable to that registered entity. Generally speaking, registered entities must submit self-certifications for the standards identified on the AML that are relevant to their registered functions, even if the entity will be audited on the same standards that year. The RE can designate additional standards for self-certifications. Advance notice is required for a self-certification, and many reliability standards specify the notice period. Most REs are in the process of adopting procedures that will require all registered entities to submit their self-certifications on a uniform schedule.

C. Spot Checks

A spot check is essentially a mini-audit and can include reliability standards identified in the AML or any other reliability standard. An RE may make a spot check to verify or confirm information received through a self-certification, self-report or a periodic data submittal,⁶⁹ in response to events,⁷⁰ or because the relevant reliability standard requires spot checks.⁷¹ Spot checks also may occur at random; the RE or NERC can decide to spot check any reliability standard in force at any time.⁷²

⁶⁸ *Regional Audit Reports of Registered Entities*, NERC, <http://www.nerc.com/pa/comp/Pages/NERC%20Regiona%20Audit%20Reports.aspx> (last visited Jan. 22, 2014).

⁶⁹ 2014 Implementation Plan at 23.

⁷⁰ *Id.*

⁷¹ See e.g., *Standard INT-007-1 — Interchange Confirmation*, NERC (January 1, 2007), <http://www.nerc.com/files/int-007-1.pdf>.

⁷² 2014 Implementation Plan at 23.

Generally, the RE will issue a notification letter to the registered entity that a spot check will be performed, the reason for initiating the spot check and the standards that will be covered. The advance notice period is specified in the relevant reliability standard or, if no period is specified, at least 20 days.

The spot check team will prepare a spot check report and give the entity 10 days to comment. The RE will provide the report to NERC, and NERC will send the report to FERC. Spot check reports are made using the nonpublic audit report template and usually are not released publicly, although FERC may do so.

D. Compliance Investigations

A compliance investigation can be initiated at any time by an RE or NERC in response to a system disturbance, a complaint or other information that indicates potential noncompliance with a reliability standard. Generally, RE staff will lead a compliance investigation. However, NERC reserves the right to assume leadership and may choose to do so to ensure consistency in investigative processes or coordinate investigations, or because the RE has a conflict. Compliance investigations are confidential, unless FERC directs that the investigation (or information obtained during it) be made public.⁷³

If the RE decides to investigate a possible incident of noncompliance, it must notify the registered entity within three days of its decision. This notice will outline the initial scope of the investigation and instruct the entity to preserve all relevant records and information. The RE will notify NERC of the investigation, and NERC will notify FERC. NERC will assign one staff member to the investigation team as a member or observer.⁷⁴ FERC also may join an investigation or initiate its own compliance investigation.⁷⁵ Investigations initiated by FERC on its own authority follow FERC's procedural rules, and penalties are applied using FERC's Penalty Guidelines.⁷⁶

An investigation may involve on-site visits, review of data and documents, and data responses verified under oath. Officers and employees may be interviewed with counsel present (for the registered entity or for the individual being interviewed). The scope of the investigation may expand beyond the initial scope described in the notice based on evidence that comes to light as the investigation proceeds.

If the RE decides that no violation occurred, it will end the investigation by giving notice to both the registered entity and NERC that it has completed its investigation. NERC will notify FERC that the investigation has ended without a violation being detected.

E. Self-Reporting

If a registered entity knows that it has violated a reliability standard, or that a violation already discovered by other means is found to be more serious than initially thought, it can self-report the violation to the relevant RE. Registered entities are encouraged to self-report as soon as possible to increase their chances of getting cooperation and self-reporting credits in the penalty calculation (see Section V.E. Penalties, below), and to minimize any harm to the bulk power system. Submission of a mitigation plan

⁷³ *Id.*

⁷⁴ NERC ROP, Appendix 4C § 3.4.1.

⁷⁵ See 16 U.S.C. 824o(e)(3); NERC ROP, Appendix 4C § 3.4.

⁷⁶ *Id.*; see also note 98.

with a self-report is viewed favorably. Roughly half of the potential violations that come to NERC's attention are the result of self-reports,⁷⁷ and NERC describes self-reports as "key to the success of the regulatory model."⁷⁸ FERC strongly encourages self-reporting in all compliance matters,⁷⁹ as does NERC.⁸⁰

As part of the RAI, NERC is seeking to improve the self-reporting process. In January 2014, it released for public comment a draft of a self-reporting user guide. The user guide discusses the proper way to fill out a self-report form, mitigating activities and guidelines for risk assessment. NERC and the REs also have begun testing an aggregated self-reporting mechanism for minimal risk violations.⁸¹ Using this mechanism, a registered entity would self-assess, identify and mitigate minimal risk breaches of the reliability standards and then report them in an aggregated spreadsheet every six months. NERC intends for the final incarnation of the program to feature real-time reporting via a web portal, with review of the aggregated violations by the RE taking place twice a year.

Compliance assessments are not formally part of the self-reporting process, but they are conducted in the same spirit.⁸² After a "reliability event," registered entities are encouraged to complete a compliance assessment. A compliance assessment reviews the facts of a system disturbance, identifies the reliability standards involved and self-reports any potential violations. In NERC's view, a compliance assessment can demonstrate the effectiveness of a registered entity's internal control "and their commitment to a culture of compliance."⁸³ This means that the registered entity "may be afforded some recognition by way of reduced levels and frequency of compliance monitoring activities," and "[a]t a minimum, the entity is typically given credit for these actions during enforcement. . . ."⁸⁴ If a registered entity does not perform a compliance assessment, or if the RE decides that the registered entity's compliance assessment is inadequate, the RE may perform an independent compliance assessment.⁸⁵

F. Periodic Data Submittals

Certain reliability standards require periodic data submittals on a monthly, quarterly or yearly basis. The RE and/or NERC may establish a schedule of submittals or request them as needed. The entity must

⁷⁷ *Internal Controls; Their Role in Electric Reliability, and Effects on Compliance Monitoring*, NERC 7 (September 20, 2012), <http://www.nerc.com/pa/comp/Audit%20Workshops%20for%20Registered%20Entities/Session%20II%20Internal%20Controls;Their%20Role%20in%20Electric%20Reliability,%20and%20effects%20on%20CM%20for%20industry.pdf>.

⁷⁸ See e.g., *ERO Enterprise Self Report User Guide*, NERC 7 (January 2014) ("Self-Report User Guide"), http://www.nerc.com/pa/comp/Reliability%20Assurance%20Initiative/UserGuide_Revised%20Jan%202014_Draft_posted.pdf.

⁷⁹ *Self Reports and Enforcement*, FERC, <http://www.ferc.gov/enforcement/self-reports.asp> (last updated July 3, 2013).

⁸⁰ Self-Report User Guide at 7.

⁸¹ NERC, *RAI Enforcement Activities Overview*, BOARD OF TRUSTEES COMPLIANCE COMMITTEE AGENDA 5-6 (Jan. 8, 2014) ("Enforcement Overview"), http://www.nerc.com/gov/bot/BOTCC/Compliance%20Committee%202013/February_5_BOTCC_Open_Package.pdf.

⁸² 2014 Implementation Plan at 25.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.* at 24.

have notice of a required data submittal equal to that provided in the relevant reliability standard, and the RE typically will provide at least 20 days' notice in any case.

G. Complaints

An RE or NERC can receive complaints via hotline, reporting form or website about violations of the reliability standards.⁸⁶ Generally, NERC will forward complaints it receives to the relevant RE,⁸⁷ but it will review a complaint itself if the RE determines that it cannot do so or if the complaint specifically requests NERC review.⁸⁸ NERC also investigates all anonymous complaints.⁸⁹ However, even if the complaint is not made anonymously, the RE (or NERC) will withhold the identity of the complainant from the subject of the complaint, unless the NERC ROP or the complainant specifically authorizes disclosure.⁹⁰

The RE will evaluate the complainant's allegations and may request more information, either from the complainant or from others. There are two possible outcomes: (1) no action on the complaint is warranted, and the matter is closed; or (2) a different compliance monitoring process is initiated, such as a compliance investigation or spot check. Once the RE decides whether or not to investigate, it will notify the complainant, the registered entity and NERC. The NERC ROP does not require that FERC be notified of a complaint. Complaints are processed in an average of 18 days.

H. Preliminary Screen

If a potential violation is detected, the RE will conduct a preliminary screen.⁹¹ The preliminary screen addresses three issues: (1) whether the relevant entity is a registered entity, (2) whether the relevant reliability standard was approved by FERC and in effect at the time of the alleged noncompliance and (3) confirmation that the violation is not a duplicate of one already under investigation. If the suspected violation does not pass the screen, then the matter is dismissed.

If the suspected violation passes the preliminary screen, it becomes a "possible violation." The RE will issue a Notice of Possible Violation (NOPV) to the registered entity, which will give a brief description of the possible violation and instruct the registered entity to preserve all relevant records. The submission of a mitigation plan at this point is encouraged, but not required. The RE will send the NOPV to NERC, which will forward it to FERC. NOPVs are nonpublic.

The seven types of compliance monitoring are not equally effective. The majority of reliability standard violations are discovered by the registered entity itself, whether through voluntary self-reporting or as part of a required self-certification. In 2012, for example, self-reports made up 47 percent of possible violations

⁸⁶ NERC ROP, Appendix 4C § 3.7. FERC also receives complaints through its enforcement hotline. Because FERC handles relatively few reliability violations directly, such complaints are generally forwarded to NERC or the relevant RE.

⁸⁷ 2014 Implementation Plan at 23.

⁸⁸ NERC ROP, Appendix 4C § 3.7.

⁸⁹ *Id.*

⁹⁰ 2014 Implementation Plan at 23.

⁹¹ NERC ROP, Appendix 4C § 3.8.

detected, and self-certifications 24 percent.⁹² Audits accounted for 26 percent of possible violations. Spot checks and investigations accounted for only two percent and one percent respectively.⁹³

V. Possible Violations Are Assigned to Different “Tracks” Based on Severity and Compliance History

Until 2012, NERC’s enforcement approach was highly mechanistic and resulted in an overwhelming backlog of lesser reliability violations. Even minor violations resulted in drawn-out enforcement proceedings that, in many cases, cost the registered entity more time, resources and hassle than they ever would in penalties. Entities with strong compliance programs often felt penalized under this system, because they were more likely to uncover minor issues than entities with weaker compliance programs.⁹⁴ As NERC observed, “[t]he focus on finding and penalizing violations appears to be leading to an undesirable, increasing focus on control and management of compliance risk and penalty liability, rather than control and management of reliability risk.”⁹⁵

In March 2012, FERC approved the FFT mechanism,⁹⁶ which allows the REs (or NERC) to post informational reports regarding certain violations, rather than filing Notices of Penalty (NOP) with the Commission for each violation.⁹⁷ Prior to FFT, there were only two possibilities once an NOPV was issued; either the matter would be dismissed when the RE concluded that no violation had occurred, or the possible violation would proceed through the NERC enforcement process, resulting in an NOP.⁹⁸ With FFT, a registered entity can choose, for certain violations, to have the matter resolved through an informational report instead.

On January 1, 2014, the REs adopted an “improved process flow” for the timely resolution of minimal risk issues. Under this process, known as “triage,” the RE will examine a potential violation within an average of 60 days and determine whether it is a minimal risk violation. If it is a minimal risk violation, then usually it will be processed using the FFT mechanism. Alternatively, the RE might determine that more information is needed or that the violation is serious enough to warrant an enforcement action leading to an NOP.⁹⁹

NERC plans to further expand the triage options to include an alternative that would allow the registered entity to bypass the enforcement process altogether for lower risk issues. Similar to prosecutorial discretion, this option would allow minimal risk issues to be identified, recorded and mitigated without

⁹² NERC, COMPLIANCE MONITORING AND ENFORCEMENT PROGRAM, 2012 ANNUAL REPORT 19 (April 2013) (“2012 Annual Report”), available at http://www.nerc.com/pa/comp/Reports%20DL/2012_CMEP_Report_Rev1.pdf.

⁹³ *Id.*

⁹⁴ See FFT Petition at 12.

⁹⁵ *Id.* at 13.

⁹⁶ FFT has been approved by FERC. *North Am. Elec. Reliability Corp.*, 138 FERC ¶ 61,193 (2012) (“FFT Order”); *North Am. Elec. Reliability Corp.*, 143 FERC ¶ 61,253 (2013) (“FFT Order II”).

⁹⁷ Under the FFT Order, the REs submitted FFT information to NERC, which submitted informational filings to FERC about violations resolved using the FFT mechanism. However, in FFT Order II, FERC approved an alternate mechanism where the REs would post their FFT information on the NERC website, and no FERC filing would be made. Instead, FERC staff would review the FFT information on the NERC website.

⁹⁸ NOPs can result from a hearing, a settlement or the registered entity accepting the finding of a violation.

⁹⁹ Enforcement Overview at 4.

becoming a “possible violation” and without triggering any sort of enforcement action, even an FFT. NERC and FERC would still be notified that the issue had occurred, however. Six REs began pilots of this alternative process in November 2013.¹⁰⁰ NERC hopes to eventually extend the possibility of discretion to moderate risk violations. Figure 2 shows the triage process and the possible outcomes.

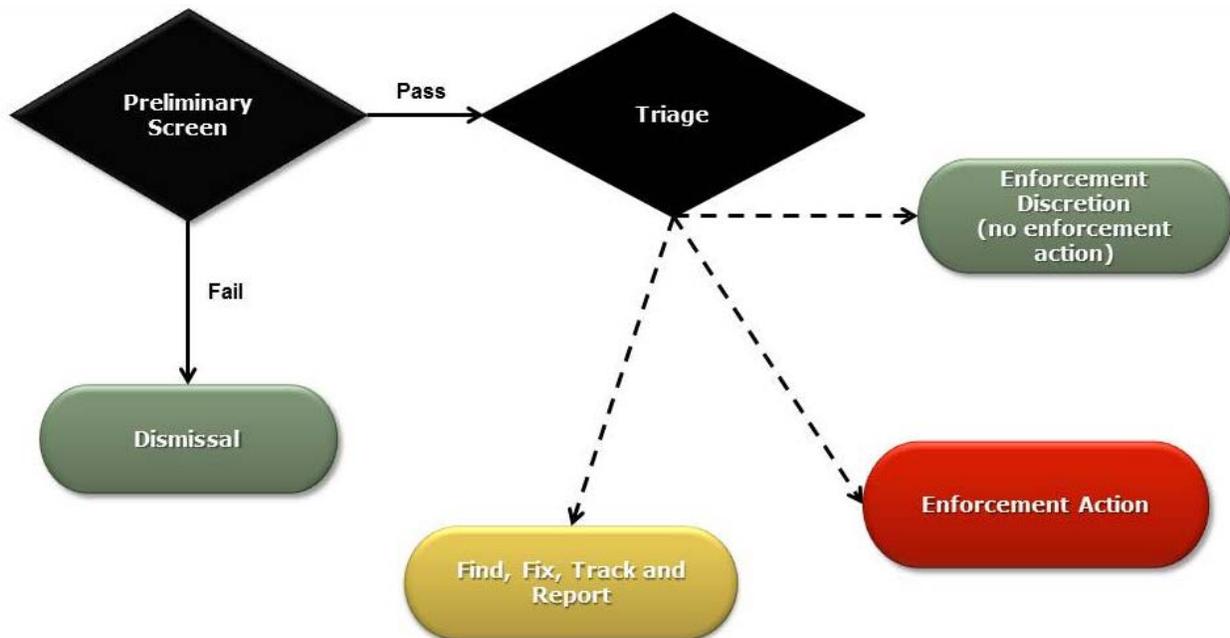


Figure 2: Triage Improved Process Flow and Possible Outcomes

A. Find, Fix, Track and Report

FFT reports identify only possible violations (which, in the FFT framework, are called “remediated issues”) and do not contain a finding that a violation actually occurred. In a sense, they are a “no contest” option; the registered entity does not admit that there was a violation, and the RE does not find one, but the registered entity is required to resolve the condition that led to the possible violation. Under FFT, the registered entity is not subject to penalties,¹⁰¹ although the possible violation will be included in its compliance history, and FFT reports are public.¹⁰² The FFT process is available for violations that pose a “lesser risk” to the BPS and has recently been expanded to cover a “limited pool” of violations that pose a

¹⁰⁰ *Id.* at 6.

¹⁰¹ It is worth noting that a zero-dollar penalty remains an enforcement option, even after NERC’s adoption of the FFT procedures. Zero-dollar penalties are penalties and may be assessed for confirmed violations. See NERC Compliance Process Bulletin #2011-007 (Dec. 9, 2011), <http://www.nerc.com/pa/comp/Resources/ResourcesDL/Public%20Notice%20Bulletin%202011-007%20Zero-Dollar%20Penalties.pdf>.

¹⁰² For violations of the CIP standards, the name of the registered entity is redacted.

“moderate risk,”¹⁰³ although other factors are taken into account. The compliance history of the registered entity will be considered, as will whether or not the particular possible violation was self-reported.¹⁰⁴

The registered entity is expected to mitigate the possible violation, although it is not required to create a formal mitigation plan as it would in an ordinary enforcement proceeding. The registered entity must submit to the RE a certified affidavit by an officer with knowledge of the remediation, stating that the possible violation has been mitigated.¹⁰⁵ The mitigation of a possible violation is subject to confirmation; if it turns out that the problem has not been mitigated, then the possible violation will henceforth be treated as a continuing violation and be ineligible for FFT treatment.¹⁰⁶ FERC has authorized the inclusion of unmitigated possible violations in FFT filings; however, full mitigation measures must be in place within 90 days of the FFT filing.¹⁰⁷ If those measures are not in place at the end of 90 days, then the possible violation will be treated like a continuing violation and will no longer be eligible for FFT treatment.¹⁰⁸

The REs post FFT reports to NERC’s website, where they are available for review by FERC and NERC.¹⁰⁹ FERC has 60 days to review FFT filings, at the end of which it considers the matters within closed, unless it gives notice otherwise. If an FFT matter is unmitigated, it will remain “open” until mitigation is complete.¹¹⁰ NERC also has a 60-day window in which to review posted FFTs; NERC’s review occurs concurrently with FERC’s review.¹¹¹

FERC has authorized NERC to expand the FFT program to include violations that pose a “moderate risk” and to allow FFT information to be posted on NERC’s website rather than filed with FERC. This expansion is conditioned on NERC making a compliance filing by June 20, 2014, demonstrating the continued success of the program.¹¹² However, the program so far seems to have been successful. More than 1,000 FFTs have been processed since the program began in September 2011.¹¹³ The processing time for violations has been reduced from an average of more than 13 months to between six and seven months over the course of 2013,¹¹⁴ and NERC’s processing backlog has been substantially reduced.

¹⁰³ FFT Order II at PP 3-4, 33.

¹⁰⁴ FFT Order at P 65.

¹⁰⁵ *Id.* at P 61.

¹⁰⁶ *Id.* at P 58.

¹⁰⁷ FFT Order II at P 36

¹⁰⁸ *Id.* at P 37.

¹⁰⁹ *Id.* at PP 38-39.

¹¹⁰ *Id.* at P 37.

¹¹¹ *Id.* at P 43.

¹¹² FFT Order II at Ordering Paragraph (B).

¹¹³ Enforcement Overview at 2.

¹¹⁴ NERC, *Key Compliance and Enforcement Metrics and Trends*, BOARD OF TRUSTEES COMPLIANCE COMMITTEE AGENDA 4-5 (February 5, 2014) (“Key Metrics”), http://www.nerc.com/gov/bot/BOTCC/Compliance%20Committee%202013/February_5_BOTCC_Open_Package.pdf.

B. Enforcement Proceedings Leading to a Notice of Penalty

If the possible violation is not assigned to the FFT track, then the RE will assess the facts and circumstances to determine whether there is evidence that the registered entity has, in fact, violated the relevant standard(s).¹¹⁵ This evaluation can be a lengthy process and may include reviewing the relevant facts, examining the wording and intent of the relevant standard, and seeing how the standard fits into the reliability functions for which the entity is registered. If no violation occurred, then the NOPV will be dismissed. Certain dismissals, such as NOPVs arising from audits, spot checks or investigations, may require preapproval from NERC.

If the RE decides that there is enough evidence that a violation occurred, the violation becomes an “alleged violation.” The RE will issue a Notice of Alleged Violation and Proposed Penalty or Sanction (NAVP”) to the registered entity by email, with copies to NERC and FERC. The NAVP is non-public.

The NAVP is essentially a charging document and is more formal and detailed than the NOPV. The NAVP must contain the reliability standard allegedly violated, the date and time the violation allegedly occurred, the facts that the RE thinks demonstrate a violation and the proposed penalty or sanction. The NAVP may include additional facts, such as extenuating or aggravating circumstances, that affect the penalty determinations.

A registered entity has four options in responding to the NAVP:

- agree with the violation and penalty and agree to submit and implement a mitigation plan;. This option will result in the issuance of a Notice of Confirmed Violation (NOCV), without further process
- agree with the violation and agree to submit a mitigation plan, but contest the penalty
- contest both violation and penalty; the entity may still submit a mitigation plan, and doing so does not waive its right to contest either the violation or the penalty
- request settlement negotiations.

The registered entity has 30 days to respond to the NAVP.¹¹⁶ If it chooses to contest either the violation or the penalty, it must prepare a verified written response to the NAVP, explaining its position through supporting documents.¹¹⁷ Settlement negotiations toll the 30-day period for a registered entity to respond to a NAVP.

¹¹⁵ The enforcement procedures described here are drawn from the NERC ROP and other official and unofficial materials. However, NERC reserves the right to use other procedures if “absolute adherence to the . . . enforcement process, to the exclusion of other approaches, may not be the most appropriate, efficient, or desirable means by which to achieve the overall objectives of the Compliance Program” NERC ROP, Appendix 4C § 5.0. The registered entity is entitled to object to the use of other procedures.

¹¹⁶ The 30-day period begins on the date that the RE sends the NAVP e-mail. NERC ROP, Appendix 4C § 5.4.

¹¹⁷ If the registered entity does not respond to the NAVP, it is deemed to have accepted the violation and penalty, and the RE will issue an NOCV.

Once the registered entity has made its response, the RE will schedule a conference with the registered entity within 10 days. These conferences provide the registered entity with the opportunity to further plead its case, offer new evidence or argue that the penalty should be reduced.¹¹⁸ If, after 40 days, the RE and the registered entity are unable to resolve the matter, the registered entity may request a hearing. The RE and the registered entity may agree in writing to extend the 40-day period.

If no hearing is requested and the 40-day period is not extended, the violation becomes a “confirmed violation,” and the RE will issue an NOCV. An NOCV looks similar to an NAVP and usually contains essentially the same facts. When the RE issues the NOCV, it will give the registered entity five days to provide a written statement to be included with the NOCV when it is submitted to NERC for approval. The registered entity’s statement also will accompany the NOP that NERC will submit to FERC.

1. Settlement

A registered entity may request settlement procedures until an NOP is filed with FERC, although the RE may decline to engage in or continue settlement negotiations after the violation becomes a confirmed violation. Settlement communications are confidential.

If the parties reach agreement, the resulting settlement must not contain terms that threaten the stability of the grid or permit reliability violations. The settlement must include a waiver of the registered entity’s right to further hearings or an appeal. Although an admission of guilt is not required, a settlement may not contain an outright denial of the violation by the registered entity. If the RE consents, the registered entity may submit an explanatory statement to be included in the settlement agreement when it is submitted to NERC.

NERC must be notified of all settlement negotiations and may choose to participate in those negotiations. Once a settlement is reached, it is reviewed by NERC, which may approve or deny it. Among other things, NERC reviews whether the settlement is consistent with other settlements entered into for similar violations or under similar circumstances. If NERC rejects the settlement, then the RE and the registered entity may attempt to negotiate a new settlement based on changes specified by NERC. If NERC approves the settlement, it is sent to FERC for final approval. Such filings contain a public, redacted form of the settlement agreement and a copy of the registered entity’s mitigation plan.¹¹⁹

Settlements make up the majority of NOPs submitted to and processed by FERC, and most settlements end with an NOP. However, NERC may issue “zero-penalty” NOPs that do not actually impose penalties, and, recently, some settlements have ended with an FFT report.

¹¹⁸ Energy Bar Association, *Discussion Regarding the NERC and Regional Entity Hearing and Appeal Processes*, 30 ENERGY L.J. 133, 142 (2009).

¹¹⁹ The NERC ROP require that NERC post settlement agreements on its website. NERC satisfies this requirement, as well as other similar requirements, by making its submissions to FERC available on its website.

2. Hearing and Appeal to NERC

Hearings before the RE are governed by Attachment 2 to Appendix 4C of the NERC ROP,¹²⁰ but each RE has its own set of procedures within these general outlines, and there are substantial differences among them, particularly with regard to the hearing body. Appendix 4C permits the hearing procedures to be waived, suspended or modified for good cause shown upon a motion by any participant or by the hearing body or officer.¹²¹

Under Attachment 2, if the registered entity opts for a hearing, it may choose either a short-form procedure or full-hearing procedure. Full hearings generally resemble an administrative hearing at FERC and are broadly trial-like, with extensive discovery, testimony, cross-examination of witnesses and, in some cases, oral argument. The shortened hearing procedures generally resemble a “paper hearing” at FERC, with written testimony and an abbreviated prehearing process. Interventions usually are not permitted in either type of hearing,¹²² and the proceedings are closed to the public.

Registered entities may appeal the outcome of a hearing at the RE level to NERC. Once the RE issues its final decision, the registered entity has 21 days to file its notice of appeal, which must include the full text of the RE’s decision. Once the notice of appeal is filed, the RE is required to submit the entire record of the investigation to NERC, together with its response to the issues raised in the notice of appeal. The registered entity then has a week to respond to the RE’s reply.

The Compliance Committee of NERC’s Board of Trustees reviews the record *de novo* and decides the appeal. It will not hear any new evidence or arguments not in the record. The Compliance Committee is permitted, but not required, to invite representatives of the entity making the appeal, and the other participants of the proceeding, to appear before it. If the Compliance Committee affirms the RE’s decision, the RE will issue an NOCV.

3. Notice of Penalty and FERC Review

NERC must file an NOP with FERC no more than five days after it approves the NOCV or settlement agreement.¹²³ The NOP is subject to *de novo* review by FERC on its own motion or upon application by the entity being sanctioned. If no review is sought or initiated within 30 days, the penalty takes effect by operation of law.¹²⁴

There are two formats of NOPs: “full” NOPs and “spreadsheet” NOPs. Spreadsheet NOPs (“SNOPs”) are produced on Microsoft Excel spreadsheets and are used for most violations, except the most serious. Generally, full NOPs are reserved for violations “(i) [] involving or resulting in (a) extended outages,

¹²⁰ If NERC conducted the investigation and initiated the enforcement proceedings directly, the hearing will be conducted under Appendix 4E of the NERC ROP, with the Compliance and Certification Committee serving as the hearing body. As with proceedings under Appendix 4C, Attachment 2, there is an option for shortened proceedings.

¹²¹ See NERC ROP, Appendix 4C, Attachment 2 § 1.1.

¹²² Interventions may be allowed under certain circumstances, such as if another party has direct interest in the outcome of the proceeding. Examples include situations where another entity has received an NAVP relating to the same set of circumstances or if an entity is contractually obligated to pay a portion of the penalty.

¹²³ 16 U.S.C. § 824o(e)

¹²⁴ 18 C.F.R. § 39.7(e)(1); NERC ROP, Appendix 4C § 5.9.

(b) loss of load, (c) cascading blackouts, (d) vegetation contacts and (e) systemic or significant performance failures; and (ii) [] involving (a) intentional or willful acts or omissions, (b) gross negligence and (c) other misconduct.”¹²⁵ A full NOP also might be used in the case of an entity with a large number of more minor violations indicative of a systemic problem.¹²⁶ Full NOPs were used for about 28 percent of the reliability violations reported to FERC in 2013. The remainder are handled through SNOPs or the FFT mechanism.¹²⁷

FERC has delegated authority to the Secretary of the Commission and the Director of the Office of Enforcement to process routine, noncontroversial NOPs that propose zero-dollar penalties and do not require further FERC consideration.¹²⁸ This delegation of authority does not apply in cases where load to customers was lost or where the NOP was the result of a hearing process.¹²⁹ Figure 3 shows a simplified graphical view of NERC’s enforcement procedures.

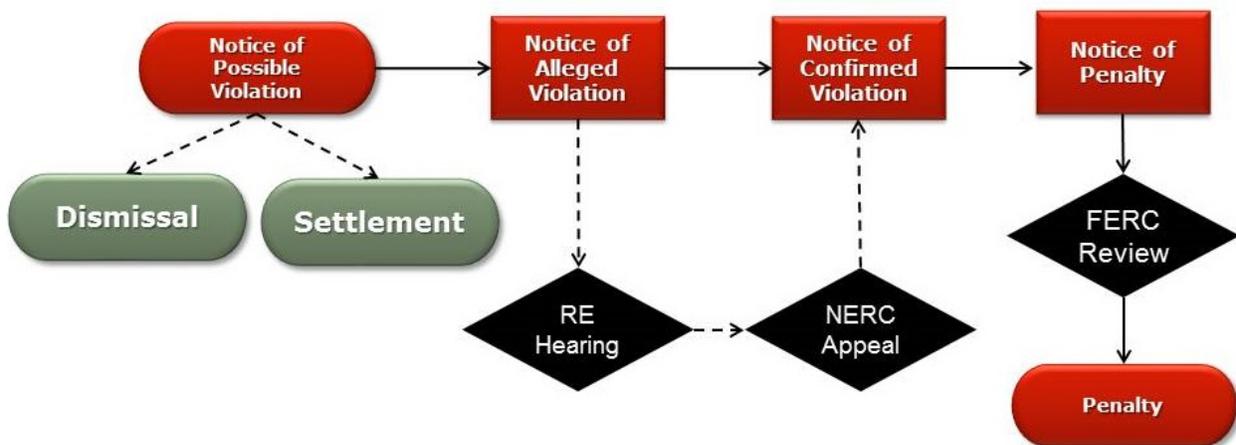


Figure 3 NERC/RE Enforcement Procedure Flow Chart

C. Mitigation Plans and Remedial Action Directives

FERC’s Commissioner Moeller testified before Congress that, “our intent is not to assess penalties, but instead, to increase compliance with our regulations.”¹³⁰ Similarly, NERC’s ultimate goal is to motivate registered entities to comply with the applicable reliability standards. Registered entities found in violation of a reliability standard must develop a mitigation plan for remedying the violation.¹³¹ When the violation

¹²⁵ FFT Petition at 23-24.

¹²⁶ *Id.* at 24.

¹²⁷ Key Metrics at 9-10.

¹²⁸ *Delegations for Notices of Penalty*, 129 FERC ¶ 61,094 (2009).

¹²⁹ *Id.* at P 8.

¹³⁰ *The Views of the Independent Agencies on Regulatory Reform: Hearing before the Subcomm. on Oversight and Investigations, H. Comm. on Energy and Commerce*, 112th Cong. 99 (2011) (written testimony of Phillip D. Moeller, Comm’r, FERC).

¹³¹ NERC ROP, Appendix 4C, § 6.1.

poses an immediate threat to reliability, the RE can issue a remedial action directive (RAD), ordering the registered entity to take specific steps to protect the bulk power system.¹³²

1. Mitigation Plans

A registered entity found in violation of a reliability standard must develop and submit to the RE a proposed mitigation plan to correct the violation. If the violation already has been mitigated, then the registered entity needs to describe how it was mitigated. Registered entities are encouraged to submit mitigation plans as early as possible.

A mitigation plan must include a description of the reliability violation that is being corrected and a description of the cause of the violation, how it will be corrected and the registered entity's plan for avoiding a recurrence of the violation. The mitigation plan also must include a target completion date that, if possible, results in the mitigation being complete prior to the registered entity's next applicable assessment or reporting period. The milestones on the registered entity's timeline for completion should be no more than three months apart to allow for the quarterly reporting of progress to the RE. The registered entity may request extensions of the completion date or the milestones, but these requests must be received by the RE a minimum of five days prior to the original completion or milestone date.

While the mitigation plan is being implemented, any sanctions associated with recurring or continuing violations of the relevant reliability standard are held in abeyance and will be waived once the mitigation plan is executed. If the violation is not resolved by the applicable completion date (including any extensions), then any violations of the relevant reliability standard that occurred after the mitigation plan was accepted will be enforced.

If the registered entity is submitting the mitigation plan because it has chosen not to contest an NAVP, then it must do so within the 30-day period to respond to the NAVP. Otherwise, the registered entity must submit its mitigation plan within 10 days of the issuance of a written hearing decision (unless the registered entity plans to appeal). The registered entity may choose to submit a mitigation plan prior to a violation being confirmed and is encouraged to do so. For example, a registered entity may submit a mitigation plan together with a self-report or in response to an NOPV or NAVP without admitting that a violation has occurred. If the registered entity does not submit a mitigation plan after choosing to contest an NAVP, then any subsequent violations of the same reliability standard that occur prior to the decision of the hearing body will be considered recurring violations.¹³³

The RE has 30 days to review a proposed mitigation plan and issue a written statement accepting or rejecting it. If the RE takes no action within 30 days, the mitigation plan will be deemed accepted. However, the RE may extend the review period upon notice to the registered entity and NERC. If the RE rejects the mitigation plan, the registered entity is required to submit a revised mitigation plan. The RE then has 10 days to review the revised plan. If it rejects that mitigation plan as well, the registered entity may request a hearing.

¹³² *Id.* §7.0.

¹³³ NERC ROP, Appendix 4C § 6.4.

If the mitigation plan was submitted prior to the issuance of an NOCV or a settlement agreement, then the RE may accept the mitigation plan on a provisional basis, subject to revision based on the RE's final determination regarding the violation. If no revisions are required after a final determination has been made, the RE will inform the registered entity that the mitigation plan is final.

Once a mitigation plan has been accepted by the RE, NERC will review the plan as well. NERC has 30 days to review the mitigation plan and inform the RE and the registered entity of its decision to approve or reject it. If it rejects the mitigation plan, NERC will provide the registered entity with an opportunity to submit a revised plan that addresses NERC's concerns. After NERC approves a mitigation plan, it will be submitted to FERC as nonpublic information. The mitigation plan will be included (redacted if necessary) in NERC's posting of any associated NOP.

The registered entity must update the RE at least quarterly regarding the implementation of the mitigation plan, and the RE may track the implementation, including through on-site visits. Once implementation is complete, the registered entity must provide a verified certification that all actions required by the mitigation plan have been completed.

2. Remedial Action Directives

An RE may issue an RAD when actions are immediately necessary to protect the bulk power system. An RAD can direct any number of actions, including specifying operating criteria, requiring specific studies, defining operating practices, requiring inspection testing, requiring training of personnel, requiring that the registered entity develop a compliance plan or imposing audit requirements. If the issuance of an RAD removes the need for a mitigation plan, the RE will inform the registered entity. The registered entity may contest the RAD using an expedited hearing process.

D. Penalties

NERC and the REs have the authority to order monetary penalties, nonmonetary penalties (such as limitations on activities, functions or operations, or placing the entity on a reliability watch list), and RADs. NERC and the REs assess penalties based on the Sanction Guidelines of the North American Electric Reliability Corporation ("Sanction Guidelines").¹³⁴ The Sanction Guidelines are entirely separate from the Penalty Guidelines used by FERC when it directly investigates reliability violations.¹³⁵ In addition to penalties, if the violation was the result of economic choice (i.e., a decision to violate the reliability standards rather than to conform to them for economic benefit), the registered entity can be required to disgorge any unjust profits or economic benefits.

The Sanction Guidelines use a three-step process to calculate a monetary penalty, with the goal that penalties should be "commensurate to the reliability impact of the violation and to those levied for similar violations, yet appropriately reflective of any unique facts and circumstances regarding the specific violation and violator."¹³⁶ The first step is to determine the base penalty amount. The base penalty is

¹³⁴ NERC ROP, Appendix 4B.

¹³⁵ See *Revised Policy Statement on Penalty Guidelines*, 132 FERC ¶ 61,216 at PP 43-49 (2010).

¹³⁶ Sanction Guidelines § 1.

calculated using the “violation risk factor” (VRF) and the “violation severity level” (VSL) of the violation. The VRF is fixed in each reliability standard and measures the risk that violating that standard might pose to the bulk power system. The VSL is the degree to which the reliability standard was violated. The VRL and VSL are used together to find the base penalty range on this chart from the NERC Sanctions Guidelines:

Violation Risk Factor	Violation Severity Level							
	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

Figure 4: Base Penalty Chart from the NERC Sanction Guidelines

The RE generally will set the penalty toward the higher end of the range, but may set it at or below the bottom of the range if the actual risk to the bulk power system from the violation was less than the VRF for that standard.¹³⁷ The RE also may use the lower part of the range, or excuse the penalty altogether, if the violation is the first violation of the relevant reliability standard by the registered entity and the impact of the violation was “inconsequential.” However, if aggravating factors are present, the RE will not lower the base penalty, even for a first offense with little impact. In setting the base penalty, the RE also will consider the “time horizon” of the violation. The RE is likely to set a higher base penalty for violations with **shorter** time horizons, because events happening in real time pose a greater risk to the bulk power system.¹³⁸

For multiple violations, the RE may choose to impose a separate penalty for each violation on a per-day basis. However, if the multiple violations are the result of a single event, or where penalties for several unconnected violations are being assessed at the same time, the RE may choose to impose a single aggregate penalty. This aggregate penalty must be at least as high as that which would be called for based on the most serious of the violations. The RE must clearly identify the method chosen and the rationale behind it.

Once the base penalty amount has been calculated, the RE will apply adjustment factors to reflect the specific facts of the violation. At minimum, the RE will consider the following:

¹³⁷ The VRF is fixed for each reliability standard based on the “expected or potential impact” of a violation. Sanction Guidelines §3.1.1. Depending on specific circumstances of a violation, the RE may determine that the actual risks posed were less than those anticipated by the reliability standard. *Id.* § 3.2.1.

¹³⁸ *Id.* § 2.7.

- the violator's compliance history and whether it has repeated violations of the same or closely related reliability standards
- failure of the violator to comply with an RAD or mitigation plan
- self-reporting and voluntary corrective action by the violator¹³⁹
- degree and quality of cooperation by the violator in the violation investigation and in any remedial action directed for the violation
- the presence and quality of the violator's compliance program
- resolution of the dispute through settlement as opposed to a hearing, and the speed with which a settlement was reached
- any attempt by the violator to conceal the violation
- intentional violations, including economic choice
- extenuating circumstances.

The resulting penalties are capped at FERC's statutory maximum penalty of \$1 million per violation per day.¹⁴⁰

Once the base penalty has been adjusted, the resulting penalty may be reviewed in light of the registered entity's ability to pay. The profit or nonprofit status of the registered entity will be considered, along with its size and financial health. If the penalty is lowered based on ability to pay, the RE may choose to impose nonmonetary sanctions as a substitute. Nonmonetary penalties can include limits on activities, functions or operations. The RE also might place the registered entity on a watch list. Nonmonetary penalties can be in lieu of or in addition to monetary penalties.

Penalties are assessed once the NOP has been approved by FERC or the 30-day period for FERC review has expired.¹⁴¹ The RE will issue an invoice to the registered entity, and the penalty will be due within 30 days of the invoice. Once the penalty is paid and all other requirements in the NOP or the settlement agreement have been met, the RE will provide the registered entity with a Notice of Completion of Enforcement Action.

¹³⁹ It is unclear whether any credit is given by an RE for an accurate but negative self-certification, where the registered entity states that it is not compliant with the relevant reliability standard. FERC has been clear that it will not give a discount on a penalty for a violation disclosed in a self-certification. *North Am. Elec. Reliability Corp.*, 124 FERC ¶ 61,015 at P 32 (2008), and the prior version of the Sanction Guidelines seemed to take the same view. However, the current Sanction Guidelines, although not suggesting the RE will lower the base penalty based on a self-certification (as it does for a self-report), state that a registered entity will not be assessed a higher penalty for a violation accurately disclosed in a self-certification if that same violation is later found in a subsequent audit or spot check. NERC ROP, Appendix 4B § 3.3.3.

¹⁴⁰ The Sanction Guidelines note that, in the case of multiple violations, even of the same standard, in a single day, penalties may exceed \$1 million per day. NERC ROP, Appendix 4B § 2.16.

¹⁴¹ 18 C.F.R. § 39.7(e)(1).

VI. A Strong Compliance Program Is Vital for Taking Advantage of NERC’s Procedural Innovations

Internal compliance programs play a major role in reliability monitoring and enforcement. Nearly half of the reliability violations processed by the ERO enterprise come from self-reports, and the Sanction Guidelines consider strong compliance programs, self-reports and voluntary remediation to be mitigating factors. The changes being adopted as part of the RAI will make internal compliance programs more central to the reliability regime.

NERC’s new focus on risk means that monitoring and enforcement processes will take into account the risk to the BPS posed by a particular entity. Key to this calculation is the registered entity’s compliance history and internal controls. Registered entities with strong compliance programs will be able to expect less scrutiny, lower penalties, and more access to FFT and enforcement discretion. New auditing procedures will include an assessment of the registered entity’s internal controls.

As NERC defines it, an internal control program “consists of processes, practices, policies or procedures” employed to help “provide a Registered Entity with reasonable assurance of compliance with the requirements of the Reliability Standards.”¹⁴² Figure 5 illustrates, in graphic form, NERC’s model for a compliance program.



Figure 5: The Inputs and Outputs of a Control Program, from NERC’s Internal Controls Working Guide

NERC describes an internal control program as having five components.¹⁴³ Two of these components will be directly evaluated as part of the audit process:

- *Monitoring* determines the effectiveness of a control process over time to determine how well a control is working and whether it needs to be modified. Monitoring should lead to a process of continuous improvement.

¹⁴² *Internal Controls Working Guide*, NERC 4 (July 9, 2013), <http://www.nerc.com/pa/comp/Reliability%20Assurance%20Initiative/RAI%20Internal%20Controls%20Working%20Guide%20Document.pdf> (“IC Working Guide”).

¹⁴³ *Internal Controls Working Guide*, NERC 4 (July 9, 2013), <http://www.nerc.com/pa/comp/Reliability%20Assurance%20Initiative/RAI%20Internal%20Controls%20Working%20Guide%20Document.pdf> (“a’IC Working Guide”).

- *Control Activities* are the actual procedures, policies and activities that comprise the heart of a compliance program. These activities may include “approvals, reviews, analysis, self-assessment, or automated processes.”¹⁴⁴ If well-designed, a control activity will consist of mechanisms to provide oversight and supervision of the activity, identify and assess deficiencies, determine how to correct deficiencies, and communicate information to the proper level of management and, if necessary, to a regulatory agency.¹⁴⁵

NERC further describes control activities by dividing them into three categories:¹⁴⁶

- *Preventive Controls* are designed to proactively discourage noncompliance with the reliability standards. Examples might include a training schedule that ensures that all required training is completed by the dates set forth in the reliability standards. This training schedule might be maintained using an automated tracking tool that notifies an individual of scheduled training and notifies management if the training is not completed.
- *Detective Controls* are designed to find errors in reliability compliance, such as a periodic review to identify required training that was not completed as scheduled or as mandated by the reliability standards.
- *Corrective Controls* are designed to restore compliance after noncompliance is detected, for example, through remedial training.

NERC has identified three “necessary elements” of a control program:¹⁴⁷

- *The Control Environment* is similar to what is often called a “culture of compliance” and involves “the integrity, ethical values and competence of the entity’s people; management’s philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.”¹⁴⁸
- *Information and Communication* involves not only data management and information technology, but also communication “in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously.”¹⁴⁹ It would also include communication with “external parties,” such as contractors, regulators and other registered entities.

¹⁴⁴ IC Working Guide at 6.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 7.

¹⁴⁷ IC Working Guide at 6.

¹⁴⁸ COSO Executive Summary at 2.

¹⁴⁹ *Id.* at 2

- *Risk Assessment* involves the identification and analysis of risks to achieving compliance with the reliability standards. NERC has outlined a framework for the sort of risks that should be considered, as discussed below.

The scale and complexity of an entity's internal controls will depend on its registered functions and size. Registered entities should assess their particular risk profile when developing their internal controls. NERC describes three types of risk:¹⁵⁰

- *Inherent Risk* is the risk posed by the registered entity's functions, size, assets, location, etc.
- *Control Risk* is the risk that noncompliance will slip through the entity's internal controls
- *Detection Risk* is the risk that noncompliance will go undetected.

Registered entities should take these types of risk into account and develop internal controls to counter them. Registered entities also are expected to continuously improve their internal controls, taking into account the controls already in place and their effectiveness.

A strong reliability compliance program also embraces a policy of self-reporting and submitting mitigation plans with self-reports, or shortly afterwards. As discussed above in Section IV.E. (Self-Reporting), both FERC and NERC view self-reporting extremely favorably. Self-reporting can result in decreased penalties, increased chance of FFT treatment and reduced scrutiny under NERC's RAI.

VII. Conclusion

The reliability enforcement regulations that have been established pursuant to Section 215 of the FPA are procedurally complex and can result in significant enforcement penalties. NERC's RAI will reward registered entities with robust, proactive compliance programs and penalize those that are less aggressive in policing themselves. A NERC compliance program should be a "living document," constantly being revised and updated to reflect best practices and internal controls. Industry best practices need to be monitored and incorporated on a continuous basis. This is particularly true of security-related issues, since violations of the CIP standards are the most common reliability violations, and these standards continue to evolve in response to potential new threats.

¹⁵⁰ IC Working Guide at 7.