

142 FERC ¶ 61,042
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

North American Electric Reliability Corporation

Docket No. FA11-21-000

ORDER APPROVING SETTLEMENT AGREEMENT

(Issued January 16, 2013)

1. The Commission approves the attached Settlement Agreement between the Office of Enforcement (Enforcement) and the North American Electric Reliability Corporation (NERC, and together with Enforcement, the Parties). This Order is in the public interest because it comprehensively resolves all outstanding issues between the Parties related to Enforcement's findings and recommendations arising out of its 2012 performance audit of NERC.

I. Background

2. Section 215 of the Federal Power Act (FPA) requires the Commission to certify an Electric Reliability Organization (ERO) to develop mandatory and enforceable Reliability Standards, subject to Commission review and approval.¹ In July 2006, the Commission certified NERC as the ERO.²

3. On August 22, 2011, Enforcement's Division of Audits informed NERC by letter that it was commencing a performance audit of NERC pursuant to FPA section 215.³ The audit letter stated that the performance audit would evaluate "NERC's budget formulation, administration, and execution[.] . . . will focus on the costs and resources

¹ 16 U.S.C. § 824o (2006).

² *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062, *order on reh'g and compliance*, 117 FERC ¶ 61,126 (2006), *order on compliance*, 118 FERC ¶ 61,030 (2007), *order on clarification and reh'g*, 119 FERC ¶ 61,046 (2007), *aff'd sub nom. Alcoa Inc. v. FERC*, 564 F.3d 1342 (D.C. Cir. 2009).

³ 16 U.S.C. § 824o (2006); 18 C.F.R. § 39.2(d) (2012).

used to achieve program objectives . . . [and] will cover the period from August 23, 2006 to the present.”⁴ The performance audit constituted the first Commission audit of the ERO.

4. On May 4, 2012, Enforcement issued its performance audit report (Audit Report) by delegated letter order. The delegated letter order stated that the Audit Report covered the period from August 23, 2006 to March 14, 2012, and contained 11 findings of fact and 42 recommendations. The delegated letter order stated that NERC had 30 days to notify the Commission as to whether it would seek a hearing, such as a paper or trial type hearing, on issues in the Audit Report contested by NERC. The delegated letter order further indicated that it constituted a final agency action with respect to any uncontested issues in the Audit Report and that NERC could seek rehearing before the Commission on the uncontested audit findings and recommendations within 30 days.

5. On May 15, 2012, NERC filed with the Commission a proposed schedule for a hearing process to address the Audit Report’s 42 recommendations. Also on May 15, 2012, NERC filed a request for rehearing of the delegated letter order issued by Enforcement, arguing that all of the recommendations should be treated as contested and subject to the hearing procedures proposed by NERC. NERC stated that its request for rehearing would be rendered moot if the Commission adopted NERC’s proposed hearing process.

6. On June 4, 2012, the Commission issued an Order on Procedures adopting NERC’s proposed process with modifications and establishing a paper hearing to address all 42 audit recommendations as well as disputed factual findings.⁵

7. Pursuant to the Order on Procedures, NERC filed an initial brief on July 19, 2012 (Initial Brief). On August 16, 2012, the California Public Utilities Commission filed a response. On August 20, 2012, non-decisional Enforcement staff filed a response to the Initial Brief (Staff Reply Brief) and the American Public Power Association, Edison Electric Institute, Electric Power Supply Association, Electricity Consumers Resource Council, Large Public Power Council, National Rural Electric Cooperative Association, and Transmission Access Policy Study Group filed a joint response. On September 10, 2012, NERC filed a reply brief (NERC Reply Brief).

⁴ The August 22, 2011 audit letter to NERC is available on the Commission’s eLibrary document retrieval system in Docket No. FA11-21-000.

⁵ *North American Electric Reliability Corp.*, 139 FERC ¶ 61,179 (2012) (Order on Procedures). In the Order on Procedures, the Commission created a separation of functions among Office of Enforcement staff, designating certain employees as non-decisional.

8. On November 2, 2012, the Commission issued an Order Accepting 2013 Business Plan and Budget of the North American Electric Reliability Corporation and Ordering Compliance Filing, which, *inter alia*, ruled on disputed Audit Report Recommendation Nos. 37 and 38 and required NERC to submit in the above-captioned docket by February 1, 2013 proposed written criteria for determining whether a reliability activity is eligible to be funded under FPA section 215.⁶ The Commission stated it will address NERC's proposed written criteria in the above-referenced docket after NERC makes the February 1, 2013 filing required in the 2013 Budget Order. The Commission's action in the 2013 Budget Order was without prejudice to any future rulings on the other Audit Report findings and recommendations.⁷

II. Audit Report Findings and Recommendations

9. In the Audit Report, Enforcement staff found 11 areas in which NERC's performance with respect to its budget formulation, administration, and execution could be enhanced: Retirement Plans; NERC Activities; NERC Budget Process; Time Reporting and Accounting System; Employee Compensation; Board of Trustees Compensation and Expenses; Standard for Determining the Reasonableness of Expenses; NERC Critical Infrastructure Protection Program; NERC as the Electricity Sector Information Sharing and Analysis Center (ES-ISAC); Employee Entertainment; and NERC Oversight of Regional Entities' Budgets.

10. In its Initial Brief, NERC contested all of the Audit Report's findings and 22 of its recommendations. Staff in its Reply Brief accepted or conditionally accepted 10 of NERC's proposed revised recommendations. NERC's Reply Brief accepted many of Enforcement staff's proposed conditions. At the conclusion of briefing, all factual findings remained in dispute and 13 recommendations had not been fully resolved.

III. Settlement Agreement

11. Enforcement and NERC resolve all matters between them related to the findings and recommendations arising out of Enforcement's 2012 performance audit of NERC by means of the attached Settlement Agreement.

12. The Settlement Agreement indicates that nothing in the Settlement Agreement limits the Commission's ability to determine the sufficiency of the criteria NERC will submit to the Commission on February 1, 2013 regarding section 215 of the FPA or whether any NERC activity is or is not eligible for funding under section 215 of the FPA. In approving the Settlement Agreement, the Commission makes no finding as to the

⁶ *North American Electric Reliability Corp.*, 141 FERC ¶ 61,086, at PP 29-31 (2012) (2013 Budget Order).

⁷ *Id.* P 29.

sufficiency of the criteria NERC will submit to the Commission or whether any NERC activity is or is not eligible for funding under section 215 of the FPA. The Commission will address those issues in a subsequent order.

13. NERC neither admits nor denies the findings of fact contained in the Audit Report.

14. In order to confirm implementation of the Settlement Agreement, Enforcement and NERC agree that NERC will submit to Enforcement's Division of Audits: (a) a plan for NERC's implementation of the Settlement Agreement and all Audit Report recommendations as revised by the mutual agreement of Enforcement and NERC in their pleadings in this proceeding and in the Settlement Agreement; (b) quarterly reports detailing NERC's progress toward implementing the Settlement Agreement and all recommendations; and (c) a report describing NERC's final implementation of the Settlement Agreement and all recommendations. The Settlement Agreement also provides that Enforcement will conduct a post-audit review of NERC's implementation of the Settlement Agreement and all recommendations.

The Commission orders:

The attached Settlement Agreement is hereby approved without modification.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

SETTLEMENT AGREEMENT

1. The staff of the Commission’s Office of Enforcement (Enforcement) and the North American Electric Reliability Corporation (NERC) (collectively, the Parties) enter into this Settlement Agreement (Agreement) to comprehensively resolve all issues related to the findings and recommendations of Enforcement’s 2012 performance audit of NERC in the above-referenced proceeding.

I. PROCEDURAL HISTORY

2. On August 22, 2011, the Office of Enforcement’s Division of Audits commenced the first performance audit of NERC, the Commission-certified Electric Reliability Organization, pursuant to the Commission’s authority under Section 215 of the Federal Power Act (FPA), 16 U.S.C. § 824o, and 18 C.F.R. part 39 (2012).¹ The audit evaluated NERC’s budget formulation, administration, and execution, focusing on the costs and resources used to achieve NERC’s program objectives, for the period August 23, 2006 to March 14, 2012.
3. The Division of Audits provided a draft audit report to NERC on March 23, 2012. NERC provided a response to the draft audit report on April 23, 2012. The final audit report was issued by delegated letter order on May 4, 2012 (Audit Report).² The Audit Report included findings of fact and forty-two recommendations in eleven areas.
4. On May 15, 2012, NERC filed a proposed schedule for a paper hearing process to address the Audit Report’s recommendations. On June 29, 2012, the Commission

¹ See Letter from Norman C. Bay, Director, Office of Enforcement, to Gerry Cauley, NERC Chief Executive Officer (August 22, 2012) (Docket No. FA11-21-000) (notifying NERC of the initiation of the audit).

² *N. Am. Elec. Reliability Corp.*, Docket No. FA11-21-000 (May 4, 2012) (delegated letter order).

adopted NERC's proposed procedural schedule with modifications.³

5. In its July 19, 2012 Initial Brief, filed pursuant to the Order on Procedures, NERC disputed all of the Audit Report's findings and twenty-two of its recommendations. On August 20, 2012, Enforcement filed a Response to NERC's Initial Brief in which it accepted or conditionally accepted ten of NERC's proposed revised recommendations. NERC filed a Reply to Enforcement's Response on September 10, 2012 in which it accepted many of Enforcement's proposed conditions. At the conclusion of briefing, all factual findings remained in dispute and thirteen recommendations had not been fully resolved.
6. On November 2, 2012, the Commission issued an Order Accepting 2013 Business Plan and Budget of the North American Electric Reliability Corporation and Ordering Compliance Filing, *N. Amer. Elec. Reliability Corp.*, 141 FERC ¶ 61,086 (2012) (2013 Budget Order), in which it, among other things, ruled on disputed Audit Report Recommendation Nos. 37 and 38 relating to NERC's development of written criteria for determining whether a reliability activity is eligible to be funded under FPA Section 215. The Commission will address NERC's proposed written criteria in the above-referenced docket after NERC makes the February 1, 2013 filing required in the 2013 Budget Order.⁴

II. AGREEMENT

7. Audit Report Recommendation Nos. 2 and 3: Unbudgeted Expenditures

- (a) The Parties agree to the following revised Recommendation No. 2:

“Continue to make improvements in budget transparency that informs the Commission, the Board and stakeholders concerning the expenditure of funds approved for specific budgeted activities on unbudgeted activities, and implement guidelines governing such expenditures, including criteria for determining when Board and Commission approval is required.”

³ *N. Am. Elec. Reliability Corp.*, 139 FERC ¶ 61,179 (2012) (“Order on Procedures”).

⁴ The Parties acknowledge that nothing in this Agreement limits the Commission's ability to determine the sufficiency of the proposed criteria or whether any NERC activity is or is not eligible for funding under FPA Section 215.

- (b) With respect to implementation of Recommendation No. 2, the Parties agree that:
- (i) Within forty-five days of the end of each quarter, beginning with the quarter ending March 31, 2013, NERC will file with the Commission the unaudited report of the NERC budget-to-actual spending variances during the preceding quarter. This report will include information regarding sources and uses of operating and working capital reserves and will match or exceed the level of detail of the quarterly budget-to-actual variance report of NERC expenditures attached to the agenda of NERC Board of Trustees Finance and Audit Committee's October 2012 meeting;
 - (ii) NERC will file for Commission review and approval Board-of-Trustees-approved proposals to expend \$500,000 or more from operating reserves designated for "unforeseen contingencies" (as that term is defined in NERC's Working Capital and Operating Reserve Policy (Reserve Policy)). Each such filing will include supporting materials in sufficient detail to justify the proposed expenditure. The filing will be deemed approved if the Commission does not act on it or issue a tolling order extending the time for Commission action within thirty days of the filing date.

The Parties agree that this requirement for Commission review and approval is triggered if any amount allocated from the unforeseen contingencies account of operating reserves plus any amount re-directed from previously budgeted funds is, in the aggregate, \$500,000 or more for any one specific project or major activity in a program area.

- (iii) NERC is not required to obtain prior Commission approval for any use of budgeted "working capital reserves" (as that term is defined in the Reserve Policy); and
- (iv) NERC is not required to obtain prior Commission approval for any expenditure of budgeted operating reserves for "known contingencies" (as that term is defined in the Reserve Policy) where operating reserves have been earmarked by NERC for the specific purposes of that expenditure in NERC's Commission-approved annual business plan and budget.

- (c) The Parties agree to delete Recommendation No. 3.
- (d) The provisions of Section 7(a), (b), and (c) are based on NERC's current Reserve Policy, which, *inter alia*, defines "working capital reserves," "operating reserves," "known contingencies" and "unforeseen contingencies." NERC will file proposed revisions to the Reserve Policy that would alter any of those definitions, or would change the Reserve Policy's requirement that all excess funds be added to the unforeseen contingency operating reserves and expended in accordance with the Policy's unforeseen contingency guidelines, for Commission review and approval.

8. Audit Report Recommendation No. 4: Granularity of Annual Budget Filings

- (a) The Parties agree to the following revised Recommendation No. 4:

"Increase the granularity of the NERC budget filings by identifying proposed budgeted expenditures, at a minimum, by the major activities to be undertaken by each program area."⁵

9. Audit Report Recommendation Nos. 9, 12 and 13: Tracking Expenses and Employee Time

- (a) The Parties agree to the following revised Recommendation No. 9:

"Utilize NERC's new time recording system to track and report employee time, at a minimum by the major activities to be undertaken by each program area."

- (b) The Parties agree to the following revised Recommendation No. 12:

"Develop and utilize written processes and procedures to allocate operating and other expenses to the major activities to be undertaken

⁵ The Parties agree that, throughout this Agreement, the term "major activities" shall have the meaning ascribed to that term in Paragraph 31 of the 2013 Budget Order. For purposes of implementation of Recommendation Nos. 4, 9 and 12, the Parties agree that Board of Trustees meetings will be one such "major activity."

by each program area using allocation method(s) that are supportable such that NERC can demonstrate that a given expense was reasonably allocated to one or more major activities.”

- (c) The Parties agree to the following revised Recommendation No. 13:

“Conduct a cost-benefit analysis of implementing a more detailed project level budgeting and accounting system and file such analysis with the Commission by March 31, 2014.”

- (d) In addition, NERC agrees to maintain its expense records as necessary to support the audit of its financial statements, its filings with FERC and the allocation of expenses contemplated by Section 9(b) above. In addition, to the extent a project level budgeting and accounting system is implemented as a result of the analysis contemplated by Section 9(c) above, NERC will maintain its expense records as required to support that system. These expense records, as well as records of employee time tracked pursuant to Section 9(a) above, will be readily accessible to NERC staff such that they can be gathered and provided to Commission staff within ten business days of a written request.

10. Audit Report Recommendation Nos. 22-24: Budgeting for Employee Expenses

- (a) The Parties agree to the following revised Recommendation No. 22: “Explicitly budget for employee rewards and recognition and entertainment expenses by including line items of sufficient granularity in the budget filings.”

- (b) The Parties agree to the following revised Recommendation No. 23:

“Use miscellaneous expense accounts to track expenses which are for employee rewards and recognition or entertainment separately from other business-related expenses in its accounting system.”

- (c) The Parties agree to the following revised Recommendation No. 24:

“Ensure rewards and recognition expenses and entertainment expenses are clearly and transparently presented to the Board, Commission, and stakeholders in the budget before these costs are incurred.”

- (d) With respect to implementation of Recommendation Nos. 22-24, NERC agrees to develop: (i) policies and procedures that identify the costs to be recorded as employee rewards and recognition; and (ii) policies and procedures for how NERC will provide such rewards and recognition. NERC will file these policies and procedures for Commission review no more than sixty days after they are finalized.

11. Audit Report Recommendation No. 25: Method of Board of Trustees Compensation

- (a) NERC agrees that (i) within ninety days of its receipt of the independent study that NERC has commissioned of Board of Trustees compensation, it will file a copy of the study for Commission review; and (ii) within thirty days after any final decision by the NERC Board with respect to the implementation of any recommendations set forth in the study, file with the Commission an explanation of the Board's decision with respect to Board compensation. The Parties agree that this resolves their dispute regarding Recommendation No. 25.

12. Audit Report Recommendation Nos. 26-28: Board of Trustees Compensation Studies and Time Tracking

- (a) NERC agrees to: (i) continue to conduct annual reviews of Board of Trustees compensation, which will take into account Trustee time and participation in Board of Trustees activities; (ii) conduct periodic market studies regarding the structure and amount of Board of Trustees compensation; and (iii) include each such annual review and periodic market study with the following year's proposed business plan and budget. NERC acknowledges that in order to take Trustee time and participation into account in its annual reviews, it will need to maintain records regarding Trustee time and participation sufficient to meet its obligations to file a Form 990 with the Internal Revenue Service, including but not limited to accurately tracking Trustee attendance at all NERC Board and Committee meetings and conference calls and any other NERC-related meetings and conference calls attended by Trustees.
- (b) The Parties agree that their disputes regarding Recommendation Nos. 26-28 will be resolved by NERC's implementation of Section 12(a), above.

13. Audit Report Recommendation No. 29: Expenses in Connection with Board of Trustees Meetings

- (a) The Parties agree that their dispute regarding Recommendation No. 29 will be resolved by NERC's implementation of the provisions of Sections 8 and 9, above.

14. Audit Report Recommendation Nos. 39-42: NERC's Role as the Electricity Sector Information Sharing and Analysis Center

- (a) The Parties agree to the following revised Recommendation No. 39:

"Initiate an open and transparent process to provide opportunities for stakeholder input regarding NERC's role as the ES-ISAC, including (1) the impact, if any, on NERC's compliance-related activities of 'walling off' certain staff from the ES-ISAC activities; and (2) access of FERC staff to ES-ISAC information for situational awareness and compliance purposes."
- (b) The Parties agree that their disputes regarding Recommendation Nos. 40-42 will be resolved by NERC's implementation of revised Recommendation No. 39.

15. NERC neither admits nor denies the findings of fact contained in the Audit Report.

16. The Parties agree that the Order on Procedures rendered NERC's May 15, 2012 Request for Rehearing in Docket No. FA11-21-001 moot.

III. IMPLEMENTATION

17. In order to confirm implementation of this Agreement and all Audit Report recommendations as revised by the mutual agreement of the Parties in their pleadings in this proceeding and in this Agreement, the Parties agree as follows:

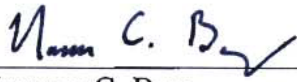
- (a) Within sixty days of the Effective Date, NERC will submit to Enforcement's Division of Audits a plan for NERC's implementation of this Agreement and all recommendations;
- (b) Within forty-five days of the end of a quarter, NERC will submit a report to Enforcement's Division of Audits detailing NERC's progress during the preceding quarter toward implementing this Agreement and all recommendations; and

- (c) NERC will submit to Enforcement's Division of Audits a report describing its final implementation of this Agreement and all recommendations no later than sixty days after NERC's fulfillment of all obligations thereunder. After receipt of such report, Enforcement will conduct a post-audit review of NERC's implementation of this Agreement and all recommendations.

IV. TERMS


- 18. This Agreement settles all matters between the Parties with respect to the contested Audit Report and comprehensively resolves all issues in the above-referenced proceeding related to the Audit Report's findings and recommendations.
- 19. The Effective Date of this Agreement shall be the date on which the Commission issues an order approving this Agreement in its entirety and without material modification.
- 20. This Agreement binds Enforcement and NERC and their agents, successors, and assigns. The Agreement does not create any additional or independent obligations on NERC, or any affiliated entity, its agents, officers, directors, or employees, other than the obligations identified in this Agreement. Enforcement and NERC do not intend for this Agreement to entitle any other party to any claim or right of any kind, it being the intent of Enforcement and NERC that this Agreement shall not be construed as a third-party beneficiary contract.
- 21. The signatories to this Agreement agree that they enter into the Agreement voluntarily and that, other than the recitations set forth herein, no tender, offer, or promise of any kind by any member, employee, officer, director, agent, or representative of Enforcement or NERC has been made to induce the signatories or any other party to enter into the Agreement.
- 22. Unless the Commission issues an order approving this Agreement in its entirety and without material modification, the Agreement shall be null and void and of no effect whatsoever, and neither Enforcement nor NERC shall be bound by any provision or term of this Agreement, unless otherwise agreed to in writing by Enforcement and NERC.
- 23. Each of the undersigned warrants that he or she is an authorized representative of the entity designated, is authorized to bind such entity, and accepts this Agreement on the entity's behalf.
- 24. This Agreement may be executed in duplicate, each of which so executed shall be deemed to be an original.

Agreed to and Accepted:



Norman C. Bay
Director
Office of Enforcement

Jan. 15, 2013



Charles A. Berardesco
Senior Vice President
North American Electric Reliability
Corporation