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those issues that present the greatest risk to reliability of the bulk power system; to encourage a culture of compliance and reliability excellence within the electric industry; and to maintain, enhance, and utilize positive relationships among NERC, the Commission, Regional Entities, registered entities, and other stakeholders within the ERO Enterprise.

II. NOTICES AND COMMUNICATIONS

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III. DISCUSSION

As reflected in the statements of Gerry Cauley, Tom Galloway and other participants in the technical conference, NERC and the Regional Entities have made substantial progress in the past three and a half years in standing up the NERC Compliance Monitoring and Enforcement Program (“CMEP”) in connection with mandatory reliability standards. In particular:

- NERC and the eight Regional Entities are performing effectively in vastly different roles from those under the pre-June 18, 2007 mandatory and enforceable reliability standards period.

- More than 1,900 entities have been registered and are required to comply with the ERO reliability standards, representing a broad spectrum of entity sizes, functions, and sectors.
- Regional Entities are executing large numbers of compliance audits per required schedules.
- To date, 5,487 possible violations have been identified, an average of 30 new violations every week since inception of the program. Of these, 1,219 have been closed through filings of Notices of Penalty, 1,265 have been dismissed, and 3,003 remain in the current caseload.
- Of the 3,003 currently active violations in the caseload, over 1,300, or nearly half, were self-reported.
- Of the 4,222 possible violations not dismissed, over 2,700, or two thirds, have already been mitigated.

In sum, more than 100 Reliability Standards containing over 1,000 separate mandatory and enforceable requirements are now being effectively monitored and enforced.

Even with the progress made in standing up the compliance monitoring and enforcement program, NERC is now working with Regional Entities and registered entities to transform the ERO Enterprise into a “learning” organization. As discussed below, this transformation is intended to rebalance the ERO Enterprise to foster compliance as much through stakeholder education on reliability excellence as it has through enforcement of mandatory reliability standards.

A. NERC Vision and the CMEP

The transformative rebalancing of the ERO revolves around five key ideas:

1. *Risk-based approach with measurable improvement of reliability performance:* NERC will utilize measures of reliability risk to demonstrate that our efforts in standards, compliance/enforcement, event analysis, education and training are having a positive impact on reliability.
2. *Reliability-learning, self-correcting industry:* NERC will strive to achieve recognition that the electric industry is a learning industry – it learns from experience and is fixing problems to ensure future reliability of the grid.

3. *Culture of compliance, enforcement backstop*: NERC intends to assist the electric industry to build a strong culture of compliance to reinforce and strengthen a culture of reliability excellence. At the same time, NERC will provide assurance to the public and governmental authorities that the ERO has a strong compliance enforcement program.
4. *Commitment to security/resilience of grid*: NERC will maintain a strong commitment by industry to ensure a secure and resilient bulk power system from high impact, low frequency threats.
5. *Positive relationships and reputation*: NERC will continue to maintain positive and constructive relationships, build trust, and exemplify collaborative leadership. This is true for fellow regulatory authorities as well as registered entities under NERC's stewardship.

These are five key success factors for the ERO, areas of focus to ensure NERC is fulfilling its reliability mission, delivering value, and serving the public interest. As reflected in the commentary at the technical conference, these five factors will have a direct impact on how NERC continues to improve and implement the CMEP for the next several years.

B. Risk-Based Approaches to Compliance Monitoring and Enforcement

Understanding risk is now central to how NERC and the Regional Entities monitor and enforce compliance with mandatory reliability standards. In 2010, NERC implemented a risk-based approach to its upcoming annual CMEP implementation plan and actively monitored reliability standards list.¹ Rather than proceeding as they had in the past by specifying an extensive list of actively monitored reliability standards that would apply equally to all registered entities in all compliance audits and other compliance monitoring activities, NERC and the Regional Entities have specified a more limited set of core requirements to be actively monitored and have allowed Regional Entities to have the flexibility to address other requirements in individual audits and other compliance monitoring activities based on individualized assessments of risks in each compliance action.

¹ The 2011 Implementation Plan is available at: http://www.nerc.com/files/2011_ERO_CMEP_Implementation_Plan_20101005.pdf. The 2011 Actively Monitored Reliability Standards list is available at: http://www.nerc.com/files/2011_ERO_Actively_Monitored_Reliability_Standards_05Oct10.xls.

Likewise, on the enforcement front, NERC has similarly incorporated risk assessment by establishing categories of Notices of Penalty and streamlining those Notices of Penalty in which risk to the bulk power system is minimal or moderate. To date, this streamlining has substantially increased efficiency with NERC now submitting Notices of Penalty covering more than four times the number of violations each month on average compared to last year. In both compliance monitoring and compliance enforcement, the risk-based approaches will drive efficiency and allow the ERO enterprise to deploy more compliance monitoring and compliance enforcement resources to matters that present the greatest risks to bulk power system reliability.

While enforcement streamlining efforts have already achieved significant efficiencies, more work needs to be done. As explained by Mr. Cauley at the technical conference, the number of new violations coming into the system continues to increase due in part to the implementation of the relatively new critical infrastructure protection (“CIP”) reliability standards. To address that wave of new violations, NERC will be implementing a new expedited administrative citation process. Based substantially on the “parking ticket” concept endorsed by the Commission,² the administrative citation process will enable NERC and the Regional Entities to submit a single streamlined Notice of Penalty covering numerous minimal-risk violations. Rather than requiring each violation to go through the several levels of process and documentation (notices, mitigation plans, settlement agreements) that have traditionally

² See *North American Electric Reliability Corporation Reliability Standards Development and NERC and Regional Entity Enforcement*, “Order on the Electric Reliability Organization’s Three-Year Performance Assessment,” 132 FERC ¶ 61,217 at P 218 (2010) (“One method that NERC and Regional Entities advocate to process enforcement matters more efficiently is to streamline procedures for handling less serious alleged violations. To this end, as we have stated previously, the Commission encourages NERC and the Regional Entities to develop flexible approaches to align the record and format of notices of penalty to the relative significance of violations, such as *pro forma* settlements and proposals for “parking ticket” or “speeding ticket” approaches that could minimize the administrative burden of performing each step in the Compliance Monitoring and Enforcement process for every violation. For example, minor alleged violations subject to a “parking ticket” approach could be aggregated and reported to the Commission quarterly, rather than through individual notices of penalty.”) (“Three-Year Assessment Order”).

applied, the administrative citation program will enable NERC and the Regional Entities to process fully these several violations with little more than a spreadsheet identifying each violation, explaining why such violation is of minimal risk to bulk power system reliability, and describing how the violation was mitigated.³ While NERC and other organizations participating in the technical conference will continue to press to have the ERO exercise enforcement discretion not to process truly minor violations at all,⁴ NERC is encouraged by the Commission's support of the administrative citation process at the technical conference and is working with Regional Entities to make the first administrative citation filing in January 2011. That support, and in particular the Commission's trust in NERC's and the Regional Entities' implementation of the administrative citation process, will be critical to ensuring that the program actually achieves the efficiencies that all parties are seeking to achieve in the enforcement process.

³ While NERC's earlier proposals of the process had treated the administrative citation as an after-the-fact quarterly report, had excluded repeat violations, and only included admitted violations, NERC has concluded that this process will operate as a Notice of Penalty to be filed formally with and accepted by the Commission, and NERC would not artificially restrict the scope of the administrative citation process. Repeat violations can qualify for the administrative citation process provided that they pose only minimal risk to the bulk power system, and the administrative citation process will be open to violations that registered entities "neither admit nor deny," in addition to admitted violations. Consistent with the Commission's support at the technical conference and its admonition in the Three-Year Assessment Order, violations processed as administrative citations will be disposed of formally and will become a part of the registered entity's compliance history. Three Year Assessment Order at P 219 ("As we stated in the Omnibus Notice of Penalty Order, the Commission expects an increasing level of compliance with the Reliability Standards as registered entities gain more experience with mandatory Reliability Standards.[] This expectation emphasizes an important consideration for penalty determinations: a registered entity's compliance history. We are concerned that an improperly designed "warning ticket" mechanism may allow a registered entity to receive a warning for practices that violate a Reliability Standard requirement, thereby resulting in an insufficient recognition of a registered entity's compliance history in a subsequent penalty matter.").

⁴ This would be consistent with the Commission's own approach to enforcement. See *Compliance with Statutes, Regulations, and Orders*, "Policy Statement on Compliance," 125 FERC ¶ 61,058 (2008) P 22 n. 27 (citations in the original) ("We also note that in many instances violations reported to the Commission are closed without sanctions. These usually involve inadvertent violations or violations that resulted from errors or misunderstandings of regulatory requirements, and which were not serious. Such resolutions normally are not made public. During the first two years of enforcement activity since passage of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), approximately 70 percent of staff investigations were terminated without any penalty, including many instances where a violation occurred. *Staff Report on Enforcement*, *supra* note 15, at 22.").

C. Encouraging a Culture of Compliance and Reliability Excellence

Aside from significant efforts to ensure that its compliance monitoring and compliance enforcement activities are efficient and focused on risk, NERC has devoted substantial effort to assisting the industry in achieving compliance and reliability excellence. As explained by Mr. Galloway, NERC has worked in the past year to develop and refine a wide array of products to give registered entities guidance on compliance and risk-minimization and to increase transparency of the ERO processes. These products include: Compliance Analysis Papers, Compliance Applications Notices, compliance and technical Lessons Learned, Alerts (advisories, recommendations, and essential actions), and Case Notes.

Moving beyond pure instruction, Mr. Galloway described an effort currently underway to enhance the Event Analysis program in a way that will encourage greater self-evaluation by registered entities. To do this, NERC has adopted new procedures for conducting Event Analyses that include revised categories of events by significance, detail an associated level of cause analysis, and set responsibilities and timing for various actions, including development of lessons learned. While NERC and Regional Entity staffs continue to stand ready to investigate events as necessary, these new procedures are intended to enable registered entities to evaluate their own events subject to review by NERC and Regional Entities. This emphasis on self-evaluation, in turn, should foster an enhanced culture of compliance and reliability excellence among registered entities. It should also improve reliability overall by utilizing the collective experience of all users, owners and operators to educate the industry. As explained by Mr. Galloway, NERC and the Regional Entities are now implementing a field trial of this new approach to Event Analysis with a number of registered entities.

D. Maintaining Positive Relationships

Finally, with regard to maintaining positive relationships, NERC indicates its support of the comments made by Stacy Dochoda, General Manager of the Southwest Power Pool Regional Entity, at the technical conference that the Commission's guidance orders on enforcement should be prospective in application, and NERC would add that continued dialog among the Commission, NERC and the Regional Entities would improve the implementation of that guidance. NERC and the Commission have benefitted from the close working relationships between their respective staffs, and while guidance orders may be needed from time to time to advance the Commission's views on enforcement of reliability standards, NERC encourages the Commission to maintain the open lines of communication and address any of the Commission's concerns in advance of such guidance orders. Even if such communication does not obviate the need for the Commission to issue a guidance order, the communication will enable the respective staffs of the Commission, NERC and the Regional Entities to align better the priorities of each respective organization. Recognizing that at any given time several cases in the ERO's caseload of active violations are in some stage of process, such communication in advance of a guidance order would enable the Commission, NERC and Regional Entity staffs to implement any such guidance as efficiently as possible with minimal disruption or re-work of cases.

IV. CONCLUSION

NERC respectfully requests that the Commission consider these comments in taking any further action with respect to the monitoring and enforcement of mandatory reliability standards.

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December 9, 2010

ATTACHMENT 1

REMARKS OF TOM GALLOWAY, NERC SENIOR VICE PRESIDENT AND CHIEF
RELIABILITY OFFICER

**Remarks of Thomas J. Galloway, Chief Reliability Officer
North American Electric Reliability Corporation**

**FERC Technical Conference on
Reliability Monitoring, Enforcement and Compliance Issues
November 18, 2010**

Good afternoon Chairman Wellinghoff, Commissioners, Commission Staff, and fellow panelists. My name is Tom Galloway and I am the Chief Reliability Officer of the North American Electric Reliability Corporation. Before NERC I was vice president and compliance director for the SERC region and, prior to that, held various positions at the Institute of Nuclear Power Operations. I appreciate the opportunity to provide comments today, and mine are sequenced per the panel one agenda topics

First, the status of compliance

- In my view, we are just now ending the ERO's startup phase
- The terrain has been challenging but the achievements significant
 - NERC and the eight regions are performing effectively in vastly different roles from those under the PRE-mandatory and enforceable period
 - More than 1900 entities have been registered, representing a broad spectrum of entity sizes, functions, and sectors
 - NERC and the regions are working to further standardize and refine processes and automate compliance information management
 - Regions are executing large numbers of compliance audits per required schedules
 - In sum, greater than 100 Reliability Standards containing over 1000 separate mandatory and enforceable requirements are now being effectively monitored
- Of compliance trends, the one I consider most significant is the continued high levels of entity self-reporting – something I consider a significant positive cultural indicator

Next, compliance consistency.

- Consistency is a key focus area with primary goals of equitable entity treatment and improved predictability

- Consistency improvements have been made in processes, execution, and rendering compliance decisions. In-process improvement actions include:
 - Cross-regional working groups – on topics like audits, enforcement, and registration – that are used to identify and correct inconsistencies, share best practices, and coordinate related activities.
 - Designation of lead regions to coordinate compliance activities for entities operating in multiple regions.
 - Process improvements, including Rules of Procedure changes.
 - Compliance Application Notices to promote consistent field decisions
 - Compliance Analysis Reports that examine causes to frequently violated standards
 - NERC observation of regional audits, and Key Reliability Spot-checks to validate regional approaches and findings and provide feedback
 - Added training for a broader set of ERO positions and topics
 - And, recently a “case-notes” process to communicate preliminary, sanitized information for important in-process determinations

- Some noted improvement opportunities exist such as added consistency in the type and level of evidence needed to demonstrate compliance, and the predictability and proportionality of compliance actions following events.

- So, while there is clearly room to improve, the ERO has made significant progress and, I believe, improvements are accelerating given the recent emphasis towards acting as one ERO-wide enterprise.

Next, Event Analysis and Compliance

- The ERO places very high value on timely and comprehensive sharing of lessons learned as a significant reliability improvement driver
- The revised process now under field trial categorizes events by significance, details associated level of cause analysis, and sets responsibilities and timing for various actions, including generation of lessons learned
- But, Events Analysis and Compliance is NOT an either or proposition
- The process sets expectations for entity self-evaluation of the compliance implications related to the event, which then are subject to validation by regional entities and NERC
- And, as before, regional entities and NERC can and will perform compliance investigations for selected events based on specific facts and circumstances

Lastly, how can the Commission, NERC, and the regional entities help create a culture of compliance?

- To promote compliance culture we must be clear on desired behaviors and aggressively reinforce them
- To me, the most important entity behaviors are:
 - CEO level engagement, demonstrating compliance as a business essential
 - Performance of systematic, critical self-evaluations
 - Timely, candid self-reporting of any findings
 - Extent of condition reviews to ensure the full scope of any violations is known
 - And, thorough, comprehensive corrective actions for identified gaps
- Reinforcement takes two basic forms
 - First, citing positive examples. Something that's not been done visibly or frequently enough to date
 - Second, greater and increasing differentiation based on observed behaviors
 - Significant enforcement moderation for desired behaviors
 - Significant escalation for undesired behaviors

I'll conclude by saying that a healthy compliance culture is essential element, but not the only element, of a strong reliability culture.

That concludes my remarks. I'd be happy to answer any questions.

ATTACHMENT 2

REMARKS OF GERRY CAULEY, NERC PRESIDENT AND CHIEF EXECUTIVE OFFICER

**Remarks of Gerry Cauley, President and Chief Executive Officer
North American Electric Reliability Corporation**

**FERC Technical Conference on
Reliability Monitoring, Enforcement and Compliance Issues
November 18, 2010**

Good afternoon Chairman Wellinghoff, Commissioners, Commission Staff, and fellow panelists.

In the past three and a half years, NERC has made substantial progress in standing up a comprehensive program for monitoring and enforcing compliance with mandatory reliability standards. Working with the Regional Entities, we have developed standardized procedures, forms, and electronic tools, and provided training to enhance the qualifications of our compliance personnel.

To date, 5,487 possible violations have been identified, an average of 30 new violations every week since inception. Of these, 1,219 have been closed through filings of Notices of Penalty, 1,265 have been dismissed, and 3,003 remain in the current caseload.

We have worked closely with Commission Staff on what constitutes an adequate record for each violation. The Commission's order of July 3, 2008 approving the first group of NOPs established a baseline of expectations regarding sufficiency of the record. The Commission's Guidance Order issued on August 27, 2010 further clarified the treatment of repeat violations. We understand what is expected by the Commission, and we continue learning and improving.

I believe our results to date have had a positive impact on reliability. The industry has invested substantial resources in achieving compliance with the NERC standards, which were previously voluntary and subject to self-interpretation. The 1,200 plus violations that have been closed and made public offer more transparency to the industry with respect to what constitutes compliance. NERC and the regions have published Compliance Application Notices to further clarify expectations.

Most importantly, of the 4,222 possible violations not dismissed, over 2,700, or two thirds, have already been mitigated. Building such a substantial record of learning-and-correcting is clearly in the public interest and is consistent with the intentions of Congress in establishing Section 215 of the Federal Power Act.

Despite this progress, I am concerned with the present caseload of over 3,000 violations, and the current pace of 200 new violations reported each month. I am concerned with the time it takes to process violations, and the administrative burden on the industry, NERC, the regions, and the Commission. Compliance results improves reliability, not compliance processing.

In some respects, I can argue that the current caseload is transitional. There was an initial wave of violations stemming from the operating and planning standards approved in Order 693, and there are strong indications in recent months this wave has crested and is beginning to subside.

We are currently experiencing a second wave of violations based on the cyber security standards. In fact, more than half of all incoming violations are related to cyber security. I worry that this wave is still building and that, even though cyber security is essential to reliability, it may draw attention from more prevalent risks related to operations and planning.

In spite of the transitional nature of the caseload, I believe there are also underlying programmatic issues to be addressed. The most important is the tendency to treat every violation as being of equal importance to reliability. Effectiveness of the compliance program depends on achieving proportionality between compliance effort and benefits to reliability.

NERC and the regions, working with the Commission staff, have made progress on this front. Earlier this year we started using an abbreviated NOP format and half of the violations in 2010 have been processed in this simplified format. NERC and the regions have worked together to align expectations regarding the quality and level of detail in filings and the amount of rework has been substantially reduced.

We have a new initiative underway to treat the lowest priority violations as administrative citations – these violations are typically related to paperwork, present the lowest risk to reliability, and are quickly remedied. We have been working with the Commission Staff on our proposal and look forward to feedback on the initial filings in early 2011.

I ask the Commission to consider over time whether there is sufficient trust in the program to allow NERC and the regions to exercise discretion to verify that minor infractions have been corrected and to maintain a record of these minor

infractions, but not file an NOP in each case. This is consistent with Order 693 (at 225) recognizing the enforcement discretion of NERC and the Regional Entities and the April 19, 2007 Order (at 133) on delegation agreements.

Finally, I will note that the NERC guidelines, which were modeled after the Commission's policies on enforcement, are entirely sufficient and appropriate in their current form to fulfill our reliability mission. The guidelines allow a wide range of penalty outcomes to reinforce positive compliance behaviors, while allowing substantial penalties to discourage egregious behavior.

If I have a concern with our enforcement actions, it is that we may be overemphasizing the need for consistent penalties on a superficial level – that a violation of a particular requirement should result in similar dollar penalties. This may provide a sense of equity and fairness to registered entities. However, it is more important to our reliability risk strategy that we understand consistency of sanctions to mean consistent with compliance behaviors to be encouraged or discouraged. I'm more interested in penalties that send the right messages than ones that send the same messages all the time.

In conclusion, I am proud of the progress we have made in developing the compliance program over the past several years. We have several great opportunities ahead to improve the expediency, consistency, and reliability benefit from our program.