BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :

RELIABILITY MONITORING : Docket No. AD11-1-000
ENFORCEMENT AND COMPLIANCE :
ISSUES TECHNICAL CONFERENCE :

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Hearing Room 2C
888 First Street, N.E.
Washington, D.C. 20426

Thursday, November 18, 2010

The above-entitled matter came on for
technical conference, pursuant to notice, at 1:02 p.m.

BEFORE:

JON WELLINGHOFF, Chairman
COMMISSIONER CHERYL A. LA FLEUR
COMMISSIONER MARK SPITZER
COMMISSIONER PHILLIP D. MOELLER
COMMISSIONER JOHN P. NORRIS
FERC STAFF PARTICIPANTS:

JOHN FIRST
Office of General Counsel

NORMAN BAY
Office of Enforcement

ROGER MORIE
Office of Enforcement

PANELISTS:

PANEL I

THOMAS GALLOWAY
Senior Vice president
Chief Reliability Officer
NERC

DANIEL SKAAR
President
Midwest Reliability Organization

STEVEN GOODWILL
General Counsel
Western Electricity Coordinating Council

DOUGLAS CURRY
General Counsel
Lincoln Electric System
PANELISTS:

PANEL I (Cont'd)

CHRIS HAJOVSKY
Director, Regulatory Affairs and
NERC Reliability Standards
RRI Energy, Inc.

PANEL II

GERRY W. CAULEY
President and Chief Executive Officer
NERC

STACY DOCHODA
General Manager
SPP Regional Entity

WILLIAM J. FEHRMAN
CEO and President
MidAmerican Energy Company

DAVID MOHRE
Executive Director
Energy and Power Division
National Rural Electric Cooperative
Association
PANELISTS:

PANEL II (CONT'D)

JOHN DISTASIO
Chief Executive Officer
Sacramento Municipal Utility District

STEVEN T. NAUMANN
Vice President for Wholesale Market
Development
Exelon Corporation
MR. BAY: Good afternoon. I am Norman Bay, the director of the Office of Enforcement at the Commission. I would like to welcome those of you who are in the audience today and those of you who are watching the webcast, the Commission's Technical Conference under liability monitoring enforcement and compliance issues and Docket No. AD11-1-00.

This technical conference follows up on the Commissions' July 6th technical conference that focused on the Electric Reliability Organizations' standards development process in communication and interactions between the Commission, NERC, and the Regional Entities.

It is in that spirit of open communications that the Commission will address today current issues relating to the compliance with Reliability Standards with two distinguished panels of experts from the industry, NERC, and the Regional Entities. The commissioners and the staff look forward to hearing your views.

Before turning the meeting over to Chairman Wellinghoff, let me cover a few housekeeping matters. We have asked the panelists to limit their opening
remarks to five minutes, so the commissioners will have sufficient time to follow up with questions.

Staff will time the presentations and inform each panelist when he or she is approaching that limit. The panelists will make the remarks in the order they are listed in the agenda.

After each panel completes their remarks, the floor will be opened to questions from the commissioners. After the commissioners finish their discussion with the first panel, we will take a short break around 2:45 p.m. before beginning the second panel.

After the discussion with the second panel is complete, we will open the floor to questions from the audience. We ask each person who wishes to pose a question at that time to come to the microphones that are set up at the edges of the seating area, identify themselves and a company or organization they are with. This is primarily to help the court reporter and the people watching the proceedings via the webcast.

Without further ado then, let me turn the floor over to Chairman Wellinghoff.

CHAIRMAN WELLINGHOFF: Thank you very much, Norman.
This is a Commission-chaired conference as opposed to a staff-chaired conference, and normally would chair the conference. However, when Commissioner La Fleur first was confirmed and we sat down and talked about her interests, she expressed to me her deep interest in reliability.

I believe in allowing people to roll their sleeves up and get right involved in things, so I have asked her to chair the conference, the technical conference, this afternoon, and she has graciously accepted that request.

My only remarks, I am very, very interested in seeing and listening to what the panel has to say with respect to reliability, monitoring, enforcement, and compliance issues. I look forward to being able to ask some questions and delve into this area. But I think it is an extremely important area for the Commission to keep on the top of our agenda, and we continue to do that. I am very, very happy to have Commissioner La Fleur having this very deep interest in this particular area.

With that, I will turn it over to Commissioner La Fleur to chair the conference.

COMMISSIONER LA FLEUR: Well, thank you very
much, Mr. Chairman. Thank you for this opportunity.
I had Chinese food for lunch in the brief time we were
out of this room, and it reminds me of the old fortune
cookie of life: "Beware of what you ask for. You may
get it."
(General laughter.)
COMMISSIONER LA FLEUR: I am, indeed, very
interested in reliability. Let me begin by joining
Norman and the Chairman in welcoming everyone to
today's conference. We are very fortunate to have two
panels that bring tremendous experience and expertise
to these topics, and I look forward to hearing their
perspectives.

Before I introduce the first panel, I have
some brief opening thoughts, and then I will turn it
over to my colleagues for their opening remarks.
Monitoring, compliance, and enforcement, the subject
of today's conference, are components of the overall
reliability structure for which FERC, Canadian
Authorities, NERC, the Regional Entities, and
Registered Entities all share responsibility.

Their purpose is at bottom to protect and
improve the reliability and security of the Bulk-Power
System by helping ensure compliance with Reliability
Standards. We have all been working on these matters
for nearly five years, and it is an appropriate time
to assess how these matters are going.

As we discuss these things today, there are
two questions in particular I hope we can reflect on.
First, are we all doing all that we can to learn from
experience and to make sure that lessons are learned
from mistakes and they are spread broadly so the same
things don't happen again? In my experience, this is
one of the most important elements of a compliance
program but usually the hardest to achieve.

Second, are we working on the right things?
Just as I think we should prioritize our efforts on
standards development, so should we ensure that the
resources collectively devoted to monitoring
compliance and enforcement are well spent and focused
to best achieve grid reliability and security.

Hopefully, in today's discussion it will
bring to light ways that we all of us involved in
these matters can step up our efforts to enhance the
reliability and security of the system for customers.

With that, I will turn it to my colleagues
beginning with Commissioner Moeller.

COMMISSIONER MOELLER: Thank you,
Commissioner La Fleur. Thanks to the members of the
two panels who are here today. Some of you have come
a great distance to be here.

I echo your thoughts that these are a couple of excellent panels. We appreciate the effort of you and those in the audience. This is part of our ongoing effort to increase the transparency of this general topic area.

Norman, thank you for your efforts on that. In addition to the work that Commissioner Spitzer and Chairman Wellinghoff have undertaken on this effort over the last few years together, I really want to commend Commissioner Norris and Commissioner La Fleur. Whether you know it or not, they have dived in from the moment they were here on reliability issues.

Again, sometimes, as we all know, these are not necessarily the most glamorous, but really what is more important than ensnuing the reliability of the Bulk-Power System. I look forward to the conference, and thank you again for everyone's effort in putting it on.

COMMISSIONER SPITZER: Thank you, Commissioner. It is a great opportunity, one of the best at FERC, to be entrusted with the mission of reliability that of course was granted by Congress in 2005. It is important that our mission not be misunderstood, and I think that there has been over
time occasionally some misunderstanding as to FERC's belief in the work that the industry, the Regional Entities, and NERC have done.

In fact, we have an admirable record of reliability with the North American Grid that we can put up beside any in the world, and we are very proud of that. At the same time, it is aspirational to have perfection even if perfection can never be achieved. We are partners -- NERC, the Regional Entities, and industry -- in our aspirational pursuit of perfection. We have that in the two panels before us.

I am fond of reciting that government is about balancing competing interests. We certainly have that in the two panels before us. With respect to Regional Entities, it is well known that there are differences across this vast country: geography, fuel use, and electrical engineering.

At the same time, there is the Congressional mandate for uniform standards for reliability. Balancing those competing interests is an interesting task, and I am sure you will offer your observations on how we balance standards across applicable across the interconnections and at the same time account for regional differences.

On the second panel, the competing interests
to be balanced I think are reflected in that old U.S. Supreme Court decision "All deliberate speed" from Brown v. the Board of Education.

Of course, "deliberate" and "speed" is an internal contradiction, but in the penalty process we want due process. We want the right to be heard, but at the same time justice delayed could be justice denied.

A number of entities have expressed concern about the temporal length of the process. We want it to be deliberate, and we want it to be swift. That is obviously the subject of a lot of discussion in balancing the competing interests on the second panel.

I mostly am here to listen. I look forward to the discussion. I again want to reiterate the pride that I have personally on behalf of my colleagues as to the work that the industry, the Regional Entities, and the ERO have done in performing their mission for reliability for the electrical grid of this country.

Thank you.

COMMISSIONER LA FLEUR: Commissioner Norris?

COMMISSIONER NORRIS: Thank you.

Welcome panelists and thanks for being here.

I am pleased that we are doing this in what is the
second of a series of technical conferences on reliability issues that was launched with the Technical Conference of July 6th. We will probably get into that one more at a 30,000-foot level conference, but at the same time we announced we were going to have that one as well because this clearly identified as an area of interest and concern for making sure we have a reliable system.

I think one consistent theme on this issue is that compliance and enforcement is about achieving better liability, not an end in and of itself. I am curious today to get a better understanding of how the role of compliance and enforcement is helping us achieve a more reliable system, which is the ultimate goal here. Thanks for what you are going to add to that discussion.

COMMISSIONER LA FLEUR: Thank you, Commissioner Norris.

PANEL I: Reliability Standards COMPLIANCE AND ITS MONITORING BY Regional Entities AND NERC

COMMISSIONER LA FLEUR: I will now introduce the first panel. I feel like a little bit like Alex Trebek. The topic will be "Reliability Standards Compliance and its monitoring by Regional Entities and NERC."
We have Tom Galloway, senior vice president and chief reliability officer for NERC; Daniel Skaar, the president of the Midwest Reliability Organization; Steve Goodwill, general counsel of the Western Electricity Coordinating Council; Doug Curry, general counsel of Lincoln Electric System; and Chris Hajovsky from RRI Energy, Inc., who is director regulatory affairs and NERC Reliability Standards.

Mr. Galloway?

MR. GALLOWAY: Good afternoon, Chairman Wellinghoff, commissioners, commission staff, and other panelists. My name is Tom Wellinghoff and I am the chief reliability officer for the North American Electric Reliability Corporation.

Prior to joining NERC, I was the vice president and director of compliance for the SERC Regional Entity. Prior to joining SERC I held various positions at the Institute of Nuclear Power Operations. I appreciate the opportunity to provide these comments today. Mine are sequenced for the panel per one agenda topic.

First, the status of compliance, in my view we are just now ending the ERO startup phase. The terrain has been very challenging, but the achievements are significant. NERC and the eight
regions are performing effectively in vastly different roles from those under the premandatory and enforceable period.

More than 1,900 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 1,000 separate mandatory and enforceable compliance requirements are now being effectively monitored.

Of the compliance trends, the one I consider most significant is the continued high levels of industry self-reporting, something I consider to be a significant, positive cultural indicator.

Next, compliance and consistency:

consistency is a key focus area with the primary goals of equitable entity treatment and improved predictability. Consistency improvements have been made in processes, execution, and in compliance decisions.

Some in-process improvement actions to keep
furthering performance in those areas include: cross-regional working groups on topics like audits, enforcement, 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 that operate in multiple regions; process improvements, including rules of procedural changes; compliance application notices that are used to promote consistent field decisions; compliance analysis reports that examine the causes that frequently violated standards and serve as a training tool for entity, NERC, and regional staff.

NERC observation of regional audits and key reliability spot checks are used to validate regional approaches and findings and provide timely feedback. Recently, a case notes process was created to communicate preliminary sanitized information for important in-process compliance determinations.

Some noted improvement opportunities exist such as added consistency in a type and level of evidence needed to demonstrate compliance and the predictability and proportionality of compliance actions following events.
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 the timely and comprehensive sharing of lessons learned as a significant reliability improvement driver.

The revised process now under Field TROC categorizes events by significance, detailed the associated level of cause analysis, and sets responsibilities and timing for various actions, including generational lessons learned. But events analysis and compliance are not an either/or proposition.

The process also sets expectations for entity self-evaluation of the compliance implications related to the event which are then subject to validation by Regional Entities and NERC. 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 regional staffs help to create a culture of compliance? To promote a culture of compliance
culture, we must be clear on the desired behaviors and aggressively reinforce them.

To me the most important reliability -- the most important entity behaviors are CEO-level engagement to demonstrate compliances, an essential business element, performance by the entity of systematic critical self-evaluations, timely and candid self-reporting of findings, extent of condition reviews that are used to ensure the full scope of any violations are fully identified, and thorough comprehensive corrective actions for identified gaps.

In terms of reinforcement, it takes two basic forms. First, citing of positive examples, role models, if you will, something that has not been done very visibly and frequently to date.

Second, greater increasing differentiation based on observed behavior, significant enforcement, moderation when desired behaviors are observed, significant escalation for undesired behaviors.

I will conclude by saying that a healthy compliance culture is an essential element, but in my view not the only element of a strong reliability culture. That concludes my remarks. Are there any questions?

COMMISSIONER LA FLEUR: Thank you very much.
Mr. Skaar?

MR. SKAAR: Good afternoon, Mr. Chairman and commissioners. My name is Dan Skaar, and I am president of the Midwest Reliability Organization. Thank you for the opportunity to participate in today's panel. I will direct my comments to the last question for this panel, which is: How can the Commission, NERC, and the Regional Entities help create a culture of compliance?

As the Commission has long recognized effective compliance programs marked by strong procedures, engaged leadership, and internal oversight provide a high level of assurance that Registered Entities are doing what they can to proactively address risk to reliability and prevent violations.

There are two areas where we can help improve compliance by these entities. First, we can devise ways to reward strong, effective compliance programs. In this regard, the most obvious way, as the Commission has pointed out, is to reduce or eliminate fines for self-reported violations. But not all self-reported violations are the same. Self-reports resulting from a strong compliance program that systematically detect, report, correct, and prevent violations and risk to reliability should
receive extra credit.

Creating an environment that welcomes self-reports as a means of identifying and correcting problems to improve reliability is essential to our success. Also, we should look at ways to prospectively reward those with strong compliance programs.

This in turn would require us to evaluate the strength of Registered Entities' compliance programs, and then we could tailor our oversight of these entities which have invested in strong compliance programs by using a more rifled approach.

Everything would be subject to audit, but we may not choose to test everything every year. We would examine those activities which pose a higher risk to reliability and then randomly select other items.

For example, in Year 1 we could audit one-third of the standards and then selectively test the other, and the same approach in the next two years, something like that. Either way we could focus on our primary goal of reliability while keeping our Regional Entities sharp and accountable and balance the work.

I believe this approach would send the right
message about the importance of compliance and help
those who may be trying to establish stronger
compliance programs in their own companies.

The second major area where we can encourage
a strong compliance culture involves improving our own
compliance procedures. To start with, we should find
ways to reduce the amount of paperwork because it
sends the wrong message that compliance is all about
paperwork. I mean, I think everybody in this room has
probably heard that several times.

Just because we can review and enforce
everything over a multiyear period during an audit
does not mean that we should in every case. For
example, a possible violation on an immaterial matter
from three years ago, which was corrected two years
ago, likely does not pose a risk today.

Currently, however, we would consider a
violation and process it for a potential remedy, more
added paperwork. Instead, we should simply score and
record the violation and move on.

Of course, we cannot ignore these matters
because we need a complete compliance record and
history. We need to maintain accountability to help
prevent the entity from reverting back to a deficient
program.
However, treating such matters in a formal enforcement proceeding may discourage a registered entity as such treatment may not provide adequate credit. Therefore, from my perspective, it would be more effective and efficient to treat an immaterial matter through some other means.

Finally, to promote a culture of compliance we should standardize the procedures around the three elements of our compliance work. In everything we do, we have to plan it, conduct it, and report it.

Unfortunately, today we measure consistency based on outcomes rather than ensuring a uniform approach to compliance monitoring on the front end. I believe we have gained enough experience over the last three years and the time is ripe for greater standardization around these three elements.

In closing, I would like to invoke the 80/20 rule, focusing on the 20 percent that will get us 80 percent of the needed results and then sampling the remaining 80 percent which will keep the industry accountable and sharp on compliance.

In fact, I would be pleased to volunteer to test such approach as a pilot program in the spirit that one year of experience is worth a thousand theories.
We appreciate the Commission's support and look forward to working with your staff to achieve a fair and balanced way to improve reliability of the Bulk-Power System.

Thank you.

COMMISSIONER LA FLEUR: Thank you very much, Mr. Skaar.

MR. GOODWILL: Commissioner La Fleur, Chairman Wellinghoff, commissioners, and staff, thank you very much for this opportunity to provide comments this afternoon on behalf of the Western Electricity Coordinating Council.

Over the course of the past three years, all of us -- FERC, NERC, the Regional Entities, and industry -- have made progress have learned a great deal about monitoring and enforcing the mandatory Reliability Standards. It is crucial that we learn from our experiences and apply those lessons going forward.

Based on WECC's experience, we believe the greatest benefit going forward can be gained from a thoughtful reprioritization of what we do and how we do it. to most efficiently maintain and enhance reliability of the Bulk-Electric System.
WECC suggests renewed emphasis on the following areas. First, we must shift resources to areas of greatest risk to the BES. We must focus on the violations that actually pose the greatest threat to reliability, and in doing so we must be willing to acknowledge when it comes to reliability not all standards are created equal.

Current monitoring efforts seem focused on the most frequently violated standards, but we propose a joint conversation with FERC, NERC, the regions and industry to instead identify the most critical standards.

To do this we must talk to the control centers, reliability coordinators, regional auditors, transmission operators, and trainers to find out what they think of the standards that matter most to system reliability.

We must also talk with the regional compliance staffs. They analyze the violations and prepare reliability impact assessments on a daily basis. They have learned a lot about which violations of which standards pose the most serious threat to reliability. And of course we must talk with industry. The front-line operators deal with reliability issues every day and have a great insight
and experience regarding reliable operation for the BES.

From these discussions, we can identify high-priority standards and then focus more resources on their monitoring and enforcement. This reprioritization must include the critical infrastructure protection, or "CIP," standards.

Regional Entities are seeing a steep increase in CIP violations very similar to the large number of violations identified when the Reliability Standards approved in Order 693 became effective.

Current processes do not appear capable of handling this quantity of violations in a reasonable and timely manner. However, just as with the Order 693 standards, we must prioritize our actions based on the recognition that not all CIP violations are of equal importance to the reliability of the Bulk-Electric System.

Rather than allowing this wave of CIP violations to overwhelm us, we believe FERC, NERC, the regions, and private industry can reach consensus on which of the new CIP standards are absolutely critical to cybersecurity and which while important do not present the same risk if violated.

NERC and the regions are developing
significant initiatives to streamline processes. We are working with NERC and the other regions to devise and test new processes, and we encourage FERC to be open to some real experimentation.

For example, WECC proposes testing truly abbreviated processes which, for instance, would involve very low-risk, low-impact violations. For these violations, enforcement could take the form of nothing more than regional tracking of mitigation efforts and repeat violations.

NERC could monitor the regions for consistency and file brief quarterly reports. FERC could sample these violations, select a subset, request the underling documentation from the region, and ensure that regional efforts are in line with expectations.

Finally, in line with these efforts to reprioritize and identify efficiencies, WECC strongly supports current efforts to make standards development and provisions processes more efficient.

In order to ensure that these drafting efforts produce clear, concise, and enforceable standards, WECC encourages the inclusion of professional facilitators and expert witnesses on standards drafting teams.
We must also continue to incorporate lessons learned from the auditors in the field into standards revisions. WECC is encouraged by and proud of the progress that has been made in the compliance monitoring and enforcement process and looks forward to working with FERC, NERC, the other regions, and industry to further improve these processes.

We encourage FERC to work with us in identifying and prioritizing those activities that will produce the most reliability benefit for the BES while recognizing the regions competence and primary responsibility in compliance monitoring and enforcement.

It is important that the regions have the freedom to act and to analyze in the first instance on the basis of their delegated authority and recognize technical expertise. NERC and the regions have made great strides in building an ERO enterprise that recognizes and leverages the strengths that each of us brings to this effort.

We look forward to building upon this success by forging a more inclusive and collaborative relationship with FERC and by focusing all of our efforts and resources on those activities that matter most to reliability. WECC believes our discussions
here today represent a significant step forward in this effort.

COMMISSIONER LA FLEUR: Thank you very much, Mr. Goodwill.

Mr. Curry?

MR. CURRY: Thank you.

I am general counsel for the Lincoln, Nebraska, Electric System and also a member of Mr. Skaar's MRO Board, but today I speak only for LES and also for the Transmission Access Policy Study Group, which is an informal association of transmission-dependent utilities in more than 30 states.

LES is a municipal electric system serving about 130,000 customers in and around Lincoln, Nebraska, with a peak load of a little over 760 megawatts. We own transmission in and around Lincoln, and we own transmission as part of the joint project involving multiple utilities.

I served as an interim CEO for LES for over a year ending in June of just this year. I can assure you as a result of that experience that LES takes compliance and is fully committed to reliability as we operate our system, and we strive to maintain a culture of compliance, and we strive even more to
achieve the culture of reliability excellence.

Our compliance committee meets monthly. We include our chief operating officer, operating division members of our executive staff, senior managers that are involved in the affected areas. All of us, all of those people, have direct access to our CEO.

The meetings are an exchange of ideas and lessons learned from our own experiences as well as borrowing from what we can learn from other utilities that are operating in our area.

MR. CURRY: (No microphone) However, we have concerns about compliance audits. Small entities with limited potential impact on reliability receive a great deal of scrutiny for potentially even more since there is less to look at. Much larger entities that have far greater impact on LES.

MR. SKAAR: The LES 2008 onsite audit, for example, took four days, which we understand to be comparable to the time spent auditing the much larger systems that have more facilities that have a greater impact on BPS reliability. NERC Sanction Guidelines rightly recognize that size matters.

A small entity with limited BPS facilities poses less risk to the BPS than a large entity that
incurs the same violation. This risk-related
assessment of seriousness should be reflected in the
auditing priorities. Reliability would be enhanced by
a risk-informed approach to development of auditing
programs, which NERC CEO Cauley included in his
February 15th vision statement.

Undue emphasis on auditing of entities that
have little or no potential impact on reliability is
in part due to the all-or-nothing approach to
registration and the push in some regions to register
entities that have little or no impact on BPS
reliability.

For example, the City of Piggott, Arkansas,
serves its 12-megawatt load through a distribution
system connected at 69 kilovolt, with a 69 KV,
transmission system. Piggott is registered as a LSE
and DP only because it is part of the regional UFLS
Program.

Piggott has no objections to being part of
that regional program and complying with the NERC UFLS
standards. However, it does question the benefits to
the BPS reliability of burdening its very small
system, which has only 12 employees working in the
electric side with compliance with all DP and LSE
standards, including the new requirements with regard
to CIP when both FERC and NERC have decided correctly already that entities like this one generally cannot impact BPS reliability. There simply should be a way to limit Piggott's compliance obligations to those standards that are specifically related UFLS.

The auditing process should encourage not penalize efforts to go beyond the minimum required for compliance. LES had an experience that was just the opposite. LES created a transmission vegetation management program that complied with NERC's standards. The program required annual patrols which could be either accomplished by foot or utility vehicle.

Annual inspections were determined to be adequate based on our anticipated vegetation growth. However, the plan went further stating that in addition LES had a contract for aerial patrols at 345 KV lines 6 times a year.

The auditors concluded that our ground control fully satisfied compliance requirements, but at the same time LES was found in violation and incurred and paid penalties because the aerial contractor had flown the lines only one time during the first five months of that year. The contract required six times per year.

To avoid the unwarranted future fines that
come from having to comply with standards or practices that exceed the standards, we removed that additional pro-reliability action from our plan. There is just simply something wrong with that picture.

Overemphasis on documentation and overly prescriptive views of what it must look like tilts expenditures toward documentation that could be better spent on improving reliability.

One entity was almost found noncompliant with the CIP-02 standard for providing its lists of critical facilities in a written paragraph stating that it had no critical assets rather than in the form of an Excel spreadsheet. The entity pushed back, and the auditors eventually accepted the documentation, but it never should have been an issue in the first place.

The auditing process would be improved by making standards clearer. For example, does "annual" mean every 12 months or once each calendar year? Is "directive" limited to instructions from an RC, or does it include everyday switching orders and generation dispatch instructions?

Unless the ambiguity is addressed through the full interpretation process, an auditor should not
1 find a registered entity in violation when its actions
fall within the range of reasonable interpretation of a given standard.

I agree with the importance of achieving a culture of reliability excellence such as NERC is seeking to promote. As our vegetation management experience shows, the compliance and the auditing process should be revamped to avoid undermining that culture of excellence.

I thank you for the opportunity to address you this afternoon and look forward to our discussion.

COMMISSIONER LA FLEUR: Thank you very much, Mr. Curry.

Lastly, Mr. Hajovsky.

MR. HAJOVSKY: Thank you and thank you to the Commission for the opportunity to get to speak in front of this -- on this topic with this distinguished panel.

My name is Chris Hajovsky, and I am with RRI Energy. We currently own and operate generation in four of the NERC Regions. We have operated generation in the Fifth Region, and upon our completion of merger with Mirant, hopefully forthcoming, we will get the opportunity to be in the Sixth Region and participate.

Today, I would like to focus my prepared remarks to three areas: consistency, documentation
monitoring of compliance, and a culture of reliability. First, to discuss consistency, consistency is an issue that presents great challenges for NERC, Regional Entities, and Registered Entities.

Indeed, every page produced by a Regional Entity and reviewed -- I'm sorry, produced by a registered entity and reviewed by a Regional Entity contains a potential consistency issue. As a result, the practice as implemented by each of the eight Regional Entities to expedite the audit process have implications on consistency.

As an example, during a recent audit in this year one Regional Entity demanded documents from early 2003, prior to when the legal duty to retain records existed and before the 2003 blackout had occurred.

However in 2008 another Regional Entity adopted a different approach to auditing the standard using June 18th, 2007, as the documentation starting point thereby avoiding a potential concern over any ex post facto regulations or derivative issues that could come up.

It is worth noting that the Regional Entity that requested such records during the 2010 audit did not make such a request in auditing an affiliate in 2009. That is not to make any negative comment about
a particular region.

It highlights the issue of consistency as well as, kind of something we will talk about in a little bit, of how regions are actively doing what they think is right and how even in doing that they could be differences of opinions that could lead to inconsistency outcomes.

Another example is one Regional Entity might recognize a self-reported violation that has a generalized high violation of risk factors but really an insignificant chance of even impacting the Bulk-Electric System as a deserving relaxed penalty assessment while another Regional Entity might ignore such considerations of impacts and simply seek to impose the maximum deterrents in the enforcement process.

In a system that places such an extreme emphasis on dotting the i's and crossing the t's, consistency will always be an unreachable goal as long as the focus is so granularly placed strict compliance with every possible tangent for interpretation for each word of the requirement.

Closely related to the topic of consistency is the topic of documenting and monitoring compliance. Compliance costs continue to escalate absent
objective, performance-based measures for reliability. For example, as we have heard, the number of Reliability Standard violations continues to grow, but there is no available measure or metric that captures that impact on the reliability of the Bulk-Electric System.

At the inception of mandatory Reliability Standards in June 2007, monitoring compliance became a primary focus for NERC and the regions in documenting compliance sufficiently enough to meet Regional Entity reviews, and has become an even greater focus for Registered Entities.

Despite a resource commitment by the industry that has grown from the Commission's initial assessment in the 2006 ERO NOPRA of an increase of only 100 hours per company to the revised average figure of just under 1,000 hours per company in Order 693 to the significantly higher resource commitment three and a half years later experienced by both regional and Registered Entities. The number of violations continues to grow as these entities become more familiar with the standards and their potential interpretations and applications.

Co-existent with the associated increase in the documentation volume and demanded granularity,
which causes a diversion of resources toward the immediate time-sensitive enforcement activities and away from tasks more directly impacting overall reliability such as training, improved maintenance and testing, and clear and concise results-based standards development.

Unfortunately, to date a comprehensive solution to stabilize this continued upward sloping trajectory of administrative violations has not emerged, and what is perceived by many as an overanalysis of each single word in a Reliability Standard versus application of the general spirit and intent of the Reliability Standard toward ensuring reliability.

As an example, just it is the continued expectation of most, if not all, entities that if one single test record out of the records for 10,000 tests is missing, the Regional Entity should self-report the issue and endure the long, detailed, resource-intensive enforcement process.

In one of our company's two self-reported violations that have made it through to the point of signing a settlement agreement, we spent close to between three-quarters and a full year of a full-time employee's worth of time collecting records for data
requests relating to this.

The message, and this is no reflection on
the region, but "FERC may ask us for this, so we need
to ask you the questions for this information."

"The Commission may ask us for this."

There is this sense of overpreparation for
something that may or may not come down the pike for
what ultimately resulted in a few thousands of
penalty. We spent a large amount of effort to prepare
every possible avenue, and that is contributing to the
situation we are experiencing today, the backlog.

Nevertheless, recognizing the criticality of
monitoring compliance, I am encouraged that the recent
consideration of the proposed parking ticket approach
to certain violations and believe this is an important
program to implement as quickly as possible.

After more than three years since mandatory
enforcement began, a strong case is emerging to find a
balance to the enforcement of major issues versus
minor issues. However, I also encourage the
Commission and NERC to look outside the box for even
more of this disposition opportunities that shorten
the process, reduce resource burden, and carry
reliability at their core rather than merely focusing
on strict compliance.
Toward this concept, I have heard many references to the nuclear industry approach for minimal infractions, which as I understand it involves kind of a balanced approach to fix it and move on. I am no where skilled in that, but I would encourage us to look at folks who have gone before us in this area and seek out the wisdom that they may have to impart on us as we address difficult situations that we have already heard several times today.

The third topic I would like to touch on deals with developing a culture of reliability. One of the most important ways to encourage a culture of reliability across the industry is to have standards that are clear and unambiguous regarding the reliability goal and the expectations of how the registered entity can demonstrate compliance.

To that end, first, it is critical to recognize that standards submitted for approval in 2006 and approved in 2007 and thereafter are not necessarily perfect. After nearly five years of developing these standards, there are many instances where the industry realizes the adequate level of reliability identified and the reliability goal of a particular Reliability Standard might involve a solution that is different from the approach of the
current standard.

Different does not necessarily mean inferior or imply de facto reduction to reliability. In many instances, different means that the proposed revised approach better conform with the understanding attained through years of observation and experience.

Second, the industry should -- toward the culture of reliability, the industry should be able to request guidance from NERC on whether an action by a Regional Entity may constitute a compliant activity in advance of engaging in such an activity.

I understand that issuing guidance such as this must be done carefully and thoughtfully. While providing guidance that must be treated as absolute may not be appropriate, there is nothing wrong with providing guidance as a safe harbor until later revised.

The Compliance Application Notice process implemented by the NERC Compliance Group is a good example of a step in the right direction. I encourage in evaluating ways to both accelerate the issuance of these notices as well as the level of detail contained in such notices.

In conclusion, cultures of reliability and compliance are best served by helping Registered
Entities avoid the current demand to overdocument compliance, anticipating every possible philosophical and possibly overanalyzed avenue in which a particular word in a standard might be interpreted by an auditor during a compliance monitoring exercise.

Objective performance-based measures of reliability applied across the regions consistently in terms of compliance should provide a ready means to that end. NERC and the Regional Entities are to be applauded for so strictly following the Commission's emphasis on monitoring compliance and aggressively documenting enforcement considerations.

However, I encourage the Commission to now consider alternative disposition opportunities. I encourage the Commission to review the nuclear industry and other forums that have gone before us. I encourage the Commission to consider systems to permit safe harbor guidance.

No one wants to reduce the reliability of the Bulk-Electric System. That is something, a message, that I hear consistently from staff members who leave the Commission and get out into the industry.

They realize, wow, people are wanting to do the right thing. It is almost surprising that good
people want to see the reliability of the
Bulk-Electric System maintained; however, everyone
desires the focus to return to actual reliability.

Thank you for allowing me the opportunity.

I look forward to the discussion.

COMMISSIONER LA FLEUR: Thank you very much,
Mr. Hajovsky. You have all given us a lot to think
about, and I guess we will turn to questions,
beginning with Mr. Chairman Wellinghoff.

CHAIRMAN WELLINGHOFF: Thank you,
Commissioner La Fleur. Mr. Galloway, I was very
interested in your bio. You actually spent 10 years
with MPO before you came to NERC.

I am wondering if you can compare and
contrast the MPO compliance culture as you left it in
the nuclear industry under MPO with the compliance
culture as you find it today in the electric industry
under the NERC/FERC regulatory structure. I would ask
you to put that in the context of two of your three
requirements for compliance, one being the CEO
engagement and the other one being timely and candid
self-reporting?

MR. GALLOWAY: Thank you, Mr. Chairman. The
closest analog I would draw, and it matches several of
the points I had in the effective compliance culture
is in the nuclear industry one of the hallmarks is an effective corrective action program that is instituted at the unit level and is run typically under a site vice president.

The basic construct of that is in the face of any ambiguity as to whether or not there is an improvement opportunity, whether it is a regulatory failure, an industrial safety near miss, anything that has to do with reliability and safety of the unit.

Employees are encouraged to come forward with that improvement opportunity or potential shortcoming into a formal system for evaluation. Within that system, those issues go through a rigorous set of steps in terms of the prioritization, the assignment of risk, the assignment of cause analysis that is on point with those risks, and then corrective action. That is instituted, again, typically at the unit level.

One of the things from a regulatory oversight that is done is that the regulator really looks at the health of that self-managed corrective action programs show some defect where they have repetitive issues, they have an issue that was of particular import that they didn't attend to appropriately, then that begets more regulatory
Now, there are exceptions to that. There are some things which are directly reported to the NRC in a formal process outside of the unit-level corrective action program, but a large number of the day-to-day issues that happened in the nuclear unit are handled through that internal process.

CHAIRMAN WELLINGHOFF: Would you characterize that process as what you would see to be a superior process to the one that we do with the NERC, FERC, or --

MR. GALLOWAY: Well, I think it is. To give you a short answer, I would say yes.

CHAIRMAN WELLINGHOFF: If it is a better structure, do you see any way we can start moving to that type of structure?

MR. GALLOWAY: Well, I think one of my opening comments was I think a positive cultural sign right now is that of all the violations we have in the system the largest fraction comes from self-reporting, which I think is a positive. I would not want to see us move in a direction where we discourage that.

What we really need to do is kind of incentivize the entities to keep coming forward with those things, and then really on a more macrobasis
look at how the entities are identifying them and
dealing with those from a process and organizational
standpoint rather than each individual issue.

Kind of managing and helping to grow the
health of their internal compliance program that would
kind of identify those issues. We are trying to do
that, incentivize that on a case basis, but as some of
the other panels have mentioned sometimes it is a
pretty arduous path.

We have examples on either end of the
spectrum in my experience where we have had entities
that come forward and done a very good job in terms of
an extended condition, and we have given them
significant credit in settlement space.

Whereas, in other cases we have really had
to engage at the regional level to kind of drive out
the full extent of condition, which turned out to be a
lot broader and maybe the entry put on that was what
would seem to be a documentation in the first instance
turned out to be an actual operational issue when we
dug into it.

To close in response, I think we need to
shift that much more focus on the entities' internal
compliance programs and continue seeing the continued
evolution of those rather than each individual
CHAIRMAN WELLINGHOFF: How about in the area of CEO engagement, do you see more or less of that with respect to NERC regulatory compliance of the Bulk-Electric System than you saw with respect to nuclear safety in the MPO model?

MR. GALLOWAY: Well, I would have to say I see a fair amount of CEO engagement. I mean, certainly any CEO in this industry right now is well aware of compliance and the implications. It is really kind of getting to a common vision of what good looks like, I think, and there is a spectrum on that right now. A lot of it around unintended consequences. Folks at a high level in the organization say, "Hey, we will have no violations, right, at our facilities." That can be construed as "Well, we shouldn't be self-reporting any potential violation, which is exactly the opposite of the behavior I think we want to incentivize.

CHAIRMAN WELLINGHOFF: Yes. That could have the opposite -- drive the opposite effect.

Let me turn to some of the other panelists for my last series here. Mr. Skaar and Mr. Goodwill I think related to some of your testimony, Mr. Skaar under the 80/20 rule and Mr. Goodwill talking about
identifying the most critical standards to focus on. How do we best get there, I guess? How do we best get
to either focusing on the things that are most
important and trying to minimize the time and effort
that we are applying to things that are not as
critical to the whole system? What are your
recommendations about how we get there?

Mr. Hajovsky, I think you touched on this as
well. You might want to begin.

MR. SKAAR: Well, I can go ahead, I guess.
Thank you.

You know, I think if you got half of the
folks from the industry in a room, we could probably
figure out what the 20 percent is, I think. I mean,
it is relay misoperations, for example. It is tree
contacts. It is training. I mean, we might argue
over the bottom two or three, but we could get
consensus, I think, quickly.

I think we know based upon not only the past
disturbances, but also I think what we see forward as
well as far as resources and things like that, I mean,
I think we could come up with the 80/20. I think when
we look, at least this is how I think about risk in my
work, there is the inherent risk of the registered
entity, which is more touch points on the BES, more
inherent risk.

Then, there is control risk or compliance risk, which would mean their compliance program potentially won't detect a problem. Weak compliance, more risk. And then there is audit risk, which is the risk that I may not find something that I potentially should have found.

To the extent that I think our work is focused on the administrative nature type things, I think our risk may go up. One of the things I have kind of looked at and studied is the SoCs learning curve recognized this, and then in 2007 they established -- this is probably too technical folks -- AS5, which effective allowed for more risk and materiality-based approaches because they were facing, I think, the same problem when that came out and then four years later they looked at different ways of looking at that. I am not saying that SoCs is a one-for-one, but I think we can compare notes.

Thank you.

CHAIRMAN WELLINGHOFF: Anybody else?

MR. GOODWILL: Mr. Chairman, I would just add to that WECC began this effort, an effort to identify the Reliability Standards posing the greatest risk this past summer by looking back at data from
July of '09 to June of 2010.

We identified the most violated standards within the Western Interconnection, but then we had the conversation that I discussed in my remarks with our own staff, our experts, and our Reliability Coordinator Centers, as well as our subject matter experts in our compliance department and found that there was very little overlap between what they felt were the most critical standards for the maintenance of reliability and the standards that were violated most often.

Now, as Mr. Skaar indicated, we would need to expand that conversation outside of WECC staff to other regions, industry, NERC, and FERC, but I believe we would fairly quickly get to some consensus on what those most critical standards are.

The problem I believe comes in operationalizing that information. While we are now aware at least within WECC for the Western interconnection, what we believe are most critical to the BES, we do have annual implementation plans that guide us in what we must audit, what standards must be self-certified to, and so forth.

It is difficult to take that information and to translate it into a more meaningful compliance
monitoring and enforcement program at this time.

CHAIRMAN WELLINGHOFF: Anybody else?

(No verbal response.)

CHAIRMAN WELLINGHOFF: Thank you.

Commissioner La Fleur?

COMMISSIONER LA FLEUR: Thank you very much Mr. Chairman.

Commissioner Moeller?

COMMISSIONER MOELLER: Thank you.

A comment and two questions: The first was I am just going to make sure to emphasize to people that today panelists and anyone from the audience, I presume we are taking comments, people shouldn't hold back. They should let us know, and I think based on our first panel that is exactly what is going to happen. We want the unvarnished perspective of people.

Mr. Galloway, you mentioned the "case notes" process. Maybe you can elaborate a little bit more on that. I am so glad you put that together, because when we were in the height of the backlog I heard a lot of frustration from people saying it was a black hole.

We didn't know what the leading violations were, and you can't learn from anybody else. It
sounds like this is the effort to address that. I would like you to explain it a little bit more and then get any of the other panelists' reactions as to if it is going well and if it can be improved.

MR. GALLOWAY: Well, thank you for the question. The case notes approach is brand new. The intent there is to kind of recognize the fact that we are not currently at a throughput level that we want in terms of the individual violations.

We do feel that to be a learning organization, if you look broadly ERO-wide, having more timely feedback to the industry in terms of issues and violations, potential violations that others have incurred, and what they have done to address those is a great source of information to put back out into the industry so it is actionable and folks can kind of in a more proactive fashion learn from others.

The balance point there was we were looking to protect the identity of the individual entity so as to not compromise their due process rights. We will sanitize that information and put it in a form where it can't be tied to any particular entity but put it out in enough granularity so that others in the industry that might be subject to the same issue can
learn from that.

COMMISSIONER MOELLER: For the panelists, have you found that helpful so far in your various roles or not?

MR. SKAAR: Well, I was actually pleasantly surprised that Registered Entities actually found it more helpful than I thought it was going to be to them. We are in the process of doing it. We think it will be a good thing.

MR. CURRY: I agree. I mean, if you don't share what you have learned from others' experiences and get it out as soon as you possibly can, you increase tremendously the risk of that event occurring again; so, it can only help.

COMMISSIONER MOELLER: Conceptually, I would completely agree with you. But have you used them? Do you recall having seen one, or is it too new to have seen some cases notes saying, "Okay, that could apply to us, and we will make a corrective action with that situation"?

MR. CURRY: It is exactly the kind of information that our compliance committee reviews on a monthly basis.

COMMISSIONER MOELLER: Great. All right. Progress. Thanks for doing that. I think that will help a lot.
The last question, specifically for Mr. Curry, is you mentioned your involvement with I guess the four-day audit from the North American Transmission Forum. I think that is the former TOOF, the "Transmission Owners and Operators Forum," it is the closest thing we have to kind of an MPO model. If you care to elaborate on how that went, we might find that interesting.

But I am also kind of interested, if you are free to talk about it, since you have an excellent culture of compliance, what did they find that you can continue to improve? Can you elaborate on that at all?

MR. CURRY: Certainly. It was intensive actual review. I think we had 24 people, industry experts, from around the country in Lincoln, Nebraska, looking at a relatively small system.

They went through everything from our control room practices to our training to our vegetation management, and concluded afterwards with an exit interview, which in this particular instance had not only senior management present, but we also had board representation in the room at the exit interview.

The remarks that we got were really very
high. There were a number of people who said, "We are
taking back lessons from Lincoln, Nebraska. They do
some things that we can incorporate."

On the other hand, they encouraged us to
formalize and spend some money in our training effort,
which we are going to do and are in the process of
upgrading. They talked to us about vegetation
management. Again, there was a difference of
interpretation that our staff had with regard to what
was required.

We were told from the peer review we were
less tolerant -- or we were more tolerant, I guess, of
that kind of growth that doesn't have any risk of
getting high up into the transmission lines. We have
changed our practices. to a certain degree with
regard to that.

All in all it was a really positive
experience. Our staff was sufficiently encouraged that
we have now got volunteers from Lincoln who have
already scheduled their peer reviews that they are
going to be doing over the course of the next year.

COMMISSIONER MOELLER: Well, very good.

Thank you. I think we have heard great things so far
about the progress of the forum, and we would at least
personally do everything that we can to encourage its
success.

Thank you.

COMMISSIONER LA FLEUR: Thank you.

Commissioner Spitzer?

COMMISSIONER SPITZER: Thank you.

This issue of the consistency of the audits is interesting to me, and Mr. Hajovsky gave two discrete examples. I alluded in my opening remarks to this tension certainly in vegetation management. The topography of the West is going to be different and management techniques would reasonably be expected to be different. The one particular example with the temporal document retention appeared to have no -- it was an inconsistency without a corresponding symmetrical benefit. That is the kind of inconsistency that we might want to eliminate.

I didn't hear specific examples from the rest of you, and I was wondering if I could elicit maybe one example from each of you of an inconsistency that you have seen that might have the symmetrical benefit such as the vegetation management among the regions, and then one such as the documentation retention '03 versus '08, was it, or '07 where it would seem to be an inconsistency in the audit that ought to be resolved?
By way of background, I was a tax lawyer in my prior life. I had a professor of law at the University of Michigan who wrote the "IRS Audit Manual," and that is the bible. I handled thousands of these types of audits from the taxpayers' point of view.

In a candid discussion once over cocktails, he admitted that the manual was designed to create an appearance of consistency across the United States from the thousands of Registered Entities.

Recognizing that the actually of such could consistency was impossible given the subjective nature of the Code, now of course are dealing with a whole different realm and I would like to think there is a bit more science to the Reliability Standards and the electrical engineering inherent therein and the Code, but at the same time there will be occasional differences in interpretation.

Mr. Curry alluded to one that maybe you could make good arguments on both sides. I do want to drill down on the issue of consistency and maybe solicit some more similar anecdotes that Mr. Hajovsky portrayed.

MR. GALLOWAY: If I may, there are actually two different examples referenced, and both of them
are familiar to me. One was what does the term "annual" mean? Just processwise what we tried to do is across each of the regions we would have a working group composed of audit managers that would meet on a periodic basis, normally every two weeks.

They would accumulate items like that, like, what is the definition of "annual," if there is any ambiguity around that. That group would discuss the range of possible applications that would be reasonable and would work towards what would seem to be a consensus decision in parallel with submitting a SAR to help refine the standards that were involved.

COMMISSIONER SPITZER: Do you end up with calendar year or 12 months?

MR. GALLOWAY: There is actually a range of possible --

(General laughter.)

COMMISSIONER SPITZER: Kind of making a point, I guess.

MR. GALLOWAY: The flip side of that is we also experience examples that that collective set of folks wouldn't feel was a valid definition of annual and it would drive towards these would be credible and these would not.

The other example that was given when we
talk about reaching back into the pre-June 18th of '07
date, that was around how do you validate the
maintenance interval for selected devices.

The point in time that you are doing the
audit, if you are supposed to be executing maybe on a
five-year interval, you need to look back "X" number
of years to validate that. There were differences in
approach on that region to region, so that would be
another such item that would get put on the list and
that group would try to drive to a consensus approach
on it

COMMISSIONER SPITZER: Is that resolved?

One would think that that would be a documentation
issue that would be without debate in order to
establish -- you have to look back to establish --

MR. GALLOWAY: I believe that is the final
position that was landed on is that if the item of
interest was the interval, and that is called out
within the standard that you have to look at Point A
to Point B in terms of time to establish that.

Those are the type of things that each and
every audit that is executed, it is like the level of
detail question that the folks in the field are trying
to work through, and processwise are trying to capture
those and get consensus going, get something into the
system to improve the standard on that front but have something that you could work operationally in the meantime.

COMMISSIONER SPITZER: Mr. Skaar, any inconsistencies that might be explainable and debatable among your colleagues?

MR. SKAAR: Sure. Well, I was going to answer the question, which may not be popular with the Registered Entities, but I just wanted to make it clear that not all Registered Entities comply with the requirements the same way, so we have to keep that in mind. There is some judgment and discretion in that. It depends on size, how they are organized, things like that. The regions need to have a little bit of flexibility for judgment and discretion on that matter.

But the consistency issue I think is real. I mean, I agree with the Registered Entities. I have talked to many of the trade associations inside my region as well as outside region; I agree with them.

Where I think we need to go is standardize on approach. In my opening remarks, I commented that everything we do we have to plan it, conduct it, and report it. What I would like to see is standardized practices around that.
I understand the "IRS Audit Manual," but there are baseline standardize practices in planning, for example, making sure that you have a sufficient understanding of the registered entity, making sure that you have a sufficient understanding of what the risks are, what the role is, things like that.

I think we could come up with a checklist which would really ease the anxiety and create, I think, more predictability for the industry so that they understand how we are going to approach it because I think predictability is a good think. It is good to be boring in our business, I think.

Then, I think in the conduct of the work, I mean, we could standardize on an evidentiary review standard, and make sure that we drill down and everybody is really trained on that.

Then, in the reports, I think we could make the reporting more meaningful for the registered entity. I think we need to look at that and MRO is -- and I am working with Mike Moon to see how we can make the reports more meaningful for the Registered Entities, and for the readers of the report.

I look at it as you can standardize on approach. Our scope may not be identical each time, and that is because you can't remove judgment and
discretion out of the field.

MR. CURRY: Just another comment related, a little expansion that I mentioned in my comments earlier. That has to do with whether we all have a common understanding of what a "directive" is. We had that arise in our first audit. It was an communication issue that I think resulted because we were so small in that our crews meet every day and then they go and they report back and the communication occurs.

The common definition of "directive" does not exist. It doesn't include a switching order, for example. It doesn't include a dispatching order. We have made that inquiry so that we could attempt to get an answer to what a "directive" is so that everybody would have the same common understanding, auditors and utilities alike. I understand it is still pending. That question is some place how it works but not in here.

COMMISSIONER SPITZER: How difficult is the fix?

MR. CURRY: I'm sorry?

COMMISSIONER SPITZER: How difficult is the fix for that?

MR. CURRY: I think it just takes an order,
somebody to determine what it means so that we all understand the same definition of the word.

MR. HAJOVSKY: If I may, to the extent that some regions feel as strongly or feel strongly in a different way, that can slow the progress down. So, the importance of having some central decision-making authority say "This is what we are going to do," the safe harbor concept that I mentioned where "For now, this is it, let's move forward," is something we should consider.

Without even talking about the directive, it just seems like at some point there needs to be -- to your point, it seems like something that needs to be a cutoff and "This is the way we are going to do it going forward."

MR. CURRY: We would just tag on to that, it is not only beneficial for those of us who have to comply, it would also help if all auditors understood that the standard was the same and they were applying the same yardstick.

The directive issue came to our attention because we were criticized for it and then subsequently were told "I think that would have been a directive, that switching order would have been a directive." The auditors were having in their
approaches to the auditees different definitions of
the same word.

COMMISSIONER SPITZER: Anything from WECC,
Steve?

MR. GOODWILL: Commissioner, I --
COMMISSIONER SPITZER: Obviously, we know
the West is different.

MR. GOODWILL: I think my focus as an
attorney advising the WECC Compliance Department has
been more on the standards themselves. I can
certainly sympathize with those in industry and our
partners at NERC and the other regions. in trying
sometimes to determine what those standards mean. It
goes back to the question about: What does "annual"
mean? What does "directive" mean?

I have found it in that role, advising
compliance, very frustrating that we could not -- that
we were left to our own as a region to figure that
out. I think we are starting to get better and better
and faster guidance from NERC.

Also, as time has gone on as Mr. Skaar
mentioned the regional auditing mangers get together
and talk, and the regional enforcement mangers get
together and talk and try to come up with some
consensus as a way to proceed. I think that has been
very, very helpful.

I would encourage to the extent that we can some process to get those interpretations out to the field, to all of us who need them much more quickly so that we all can apply a common definition to what are oftentimes difficult standards to interpret.

COMMISSIONER SPITZER: One final point. I have heard quite a bit over the last couple of years that there is a feeling in the regulated community that "You've got too much obsession with documentation" and that we are chasing squirrels and looking at documents and not focusing on the real reliability metrics.

This is probably more geared towards Chris and Mr. Curry. My experience in the tax law was that where I had clients that had good documentation, oftentimes you would end up with a clean return. And those that had documentation problems, guess what, they had issues.

There was this nexus, not a perfect correlation but nevertheless the documentation, a failure of documentation reflected in some cases a lack of internal controls and discipline that led to more serious matters. What would be your response to that?
MR. HAJOVSKY: I absolutely agree with your analogy. But to my prepared remarks, I used the term "strict compliance." "Strict compliance" deals with anything down to one word. Your example deals with documentation problems and systematic issues that are embedded in an organization and would agree with exactly what you are describing. However, one of my examples was one test out of 10,000 would still count as a violation here. That is not a systemic problem. That is somebody thought they clicked "save" on an SAP submittal through their program, and it didn't get embedded well and so the auditor comes and sees "Oh, you've got a really good program. Everything is well done behind the scenes. I completely understand how this type of thing"; so, there is a difference in the analogy, and that is the way I would respond to that part.

COMMISSIONER SPITZER: All right.

MR. CURRY: I would just add that documentation may or may not be a reliability problem. I assert that it has to go hand in hand with performance, that you can't divorce reliability performance from documentation.

If you look at documentation in a given situation and you find three or four times during the
course of the year that something was not documented, but it is obvious from the performance that the act occurred, that is not a reliability problem. That may have been a bad day. It ought not to be a sanctionable event.

But on the other hand, if you look at the same number of documentation omissions and can couple them to something that was happening, an incident that was occurring, clearly it is telling you something.

COMMISSIONER LA FLEUR: Thank you.

Commissioner Norris?

COMMISSIONER NORRIS: Thank you.

Let me throw one question out, pose it to all of you, and I guess have a few individual followup questions here. The first one is one of you mentioned the issue, which maybe it is not an issue, or if it is, I am curious to your thoughts on the tension between event analysis and the lessons gained from that and the NERC RE need to investigate on compliance and enforcement. Is there a tension, and how do we deal with that?

MR. GALLOWAY: Well, I think there is. The way I would characterize it is I don't think it is an either/or proposition. I think if an event occurs on the system, and we can have a debate about what
constitutes an event, but we have moved to putting some framework around the threshold that you would consider something an event and then categorization within that as to how severe it was.

From a reliability context, what you want is you want the entity to learn from that and fix that so that they don't have a repetition of that issue, but also want everybody else on the system who might be susceptible to it to learn from that as well.

You also want the entity when they are looking at the facts and circumstances around the event to understand was a cause or contributor related to that a failure to comply with existing standards or perhaps a gap in the existing set of standards that exist that could be closed.

I think there are kind of parallel activities, but we do get into some tension around the sequencing of those activities and, for lack of a better term, how "expansive" a compliance review needs to be undertaken for different significance events.

If you have something that is on a low order, a relatively low-significance event, there is an item to be gained from that. There is a compliance that might be appropriate from that, but it is not necessarily the best use of the entity, NERC time, to
do a completely expansive review of every potential compliance consideration that might be involved there. Probably a superior way to do that is to look at those low-level events in a trending way to see is there repetition either with that entity or across that topic or across multiple entities that should be looked at in a more intrusive way downstream.

I think to me it is not an either/or proposition. It is really appropriately balancing both ends of that and really to what extent and what scope really from a compliance perspective makes sense for a given event, specially those low-level events.

COMMISSIONER NORRIS: Anybody else?

MR. SKAAR: Sure. Thank you. I think you raised a good point. There has been tension. We certainly have lived through it. I think one of the things we concluded was when there is an event, we should set the expectation that there is going to be a compliance review at the end. That is number one.

But I don't think that compliance review, because there is always time for determining culpability, should not interfere with having the technical people from the industry which we rely on for this to figure out what happened, what did we
learn, how we can prevent it.

What I have seen is if you pull the trigger on an investigation simultaneously, it can chill the technical analysis, which is unfortunate. We want to avoid that. I think setting the expectation that there will be, one, but we are not going to let that interfere with our work, and we need to be smart about it.

For example, we need to protect ourselves related to data. Maybe on event analysis or when an event occurs set the expectation and pull all your data so that it can be preserved.

Thank you.

COMMISSIONER NORRIS: Mr. Curry?

MR. CURRY: I would just like to jump in and say amen to what Mr. Skaar just said. The enforcement, the holding the entity accountable for a violation can wait, but the more important has got to be to share the lesson and get it to everybody else so that we can learn.

COMMISSIONER NORRIS: Mr. Curry -- oh, no, Mr. Goodwill first. You mentioned that the right people in the room could come up with some standards that are really critical. I think that is a summary of one of our comments, to come up with some standards
that are critical to reliability. There is a number
of them that are most critical. How does that happen?
You are empowered today to pull the right people in
the room. Give me a little sense of how we pull that
off.

MR. GOODWILL: Mr. Norris, I think as I
mentioned, it really would start out as a discussion
from FERC, through NERC, the regions, and the industry
with our CIP experts as to what they believe. I mean,
as an attorney on a daily basis working with our
compliance department, I would discuss with our CIP
SMEs, our CIP auditors, the reliability impact of a
given violation. They know when they look at a
particular standard and a particular violation and the
facts on the ground that an entity -- they very
quickly have a good sense of how serious they think
that impact, the risk, is from that violation. I
think you can do the same thing in a larger
conversation to get at the heart of what is important
in CIP.

For instance, we end up treating all
violations the same. There might be different
penalties proposed at the end of the day, but an
entity failing to produce evidence that a senior
manager actually approved their security plan may well
be different than a violation going to the six-wall requirement for physical security for a CIP facility, yet they all go through the notice of alleged violation process. They all go through the same, hopefully, settlement process and up through NERC and on to FERC through the same NOP process.

I think we could target our resources better to finding and fixing the things that matter most if we were able to deal with those differing types of violations in different ways at the very beginning of the enforcement process.

Back to your question. I might be naive, but I think, again, with the 693 standards I don't think it would be that difficult to find a relatively good consensus fairly quickly on what our experts think matters most to reliability.

MR. HAJOVSKY: If I may just add a quick other set of examples. I agree that I think it would be fairly easy to do. I think somebody had made the comment a certain amount we might have some discussion over. Some more examples are CIP-04 requires training on an annual basis for those who have access to critical cyber assets.

Well, if you missed that by a day in your annual training, that is the type of thing that gets
reported, going back to the granularity, and those
could be handled in a different way by missing
something by a quarter or even six months, by a
tracking glitch.

Another might be if you didn't update your
password in a period of time from another standard.
There are these type of routine elements in the CIP
standards that are a different category in my opinion
than as you used the 6-wall example, analogy. I think
there are a lot of examples we could easily parse out.

COMMISSIONER NORRIS: This may be an example
of a topic for our next tech conference on setting
priorities, so I just wanted to flesh that out a
little bit. Mr. Curry, hear a lot, and I think Mr.
Spitzer asked you some questions relative to this,
about concerns for smaller entities. Sometime the
notion of critical assets and cybersecurity can be
overwhelming because it seems larger and it may be an
issue that I will not have dealt with as much.

Put me inside a half a dozen of your
counterparts, what is the conversation? What is the
problem? What do we need to do about it? I think it
is the burden of compliance if it is an organization
that is of some size.

If it is Piggott, Arkansas, it is "Why in
the world if the only thing I am responsible for is that UFLS responsibility to maintain that program and perform well, and if my 12-megawatt system blows up and goes off the face of the earth, is it any threat at all to the BPS?

I mean, that is just requiring them to do something that won't contribute anything to the reliability of the BPS.

COMMISSIONER NORRIS: Is there a recognition though that their system could be an access point for cyber?

MR. CURRY: Insofar as it would touch the UFLS obligation, certainly. But is there a requirement that they have to maintain the same degree of awareness and reliability with regard to the operation of their system that would have to be the case with regard to a much larger system or a system that if it failed would impact the system?

COMMISSIONER NORRIS: Is it a question of the same degree, or is it a question of they really don't know what that degree is, and the uncertainty of that is intimidating?

MR. CURRY: I don't have any evidence to suggest they don't know what it is, but it wouldn't surprise me to find that that is the case. If you've
got a couple of dozen people working for your entire utility, you are not going to have the same level of specification awareness knowledge of what the requirements are that you will be able to maintain in a much larger system.

In LES' case, we really take seriously the matter of compliance. We have the compliance committee that is headed by a young engineer who is enthused and forceful and doing a great job for us. He knows he can talk to anybody at LES, if he has to, in order to identify problems and get the support that he needs.

They meet monthly. They are candid. They are honest. They hold no punches. They come after each other. That is the kind of culture of compliance we want but it is driven because reliability is really our concern, and that I think is going to be a culture that may vary from utility to utility, but the larger you get perhaps to a certain point the easier it is to maintain that culture. I suspect you get to the point where you are so large that it becomes a handicap. On either extreme, maybe you've got the problem of maintaining consistency, maintaining common understandings. But the vast majority in the middle should be able to make that accommodation and comply.
COMMISSIONER NORRIS: I do think -- I'm sure we will have more conversations about this going forward -- but there has to be some way to assist the smaller entities with technical expertise and ability to handle this because there is a scale problem here. I think we need to keep that in mind going forward.

MR. CURRY: We've got more people on our committee than Piggott, Arkansas, has for the entire operation of the system.

COMMISSIONER NORRIS: We won't give the same deference when they join the big 10, but we will for smaller ones.

(General laughter.)

MR. CURRY: That is understood.

COMMISSIONER NORRIS: Okay. Finally, Mr. Skaar, you talked about the culture of compliance and the self-reports and how you want to prepare and eventually reward strong programs because that yields a self-report. How do we treat the self-report that is the result of an audit notice? Does that help the culture of compliance to credit a show of compliance, or does that hinder to get a credit for a self-report subsequent to an audit notice?

MR. SKAAR: Is this a self-report prior to an audit or after?
COMMISSIONER NORRIS: It is a self-report subsequent to a notice of a pending audit. Does that help the culture of compliance or hurt the culture of compliance.

MR. SKAAR: Do you mean after an audit is -- let me make sure I've got the example. After an audit is complete?

COMMISSIONER NORRIS: No, no, after receiving notice of a pending audit.

MR. SKAAR: No. Once you receive, I think we use 90 days now, because I think the trade associations wanted to use 90 days rather than 60 days on the notice, our view is once we give you that audit notice, I mean we really need to peel back that self-report.

As I said, all self-reports are not the same. If this was a self-report by accident that or through preparation for an audit, that is different than a self-report as a result of a strong compliance program, not part of that audit period.

I think that we have to be very discerning about self-reports, but it works the other way as well. Repeat violations, for example, as a result of a strong compliance program, I mean, I don't automatically think repeat violations should be
considered aggravating.

I mean, it depends on the situation. It really depends on the strength of the compliance program. I say "program" rather than "culture" because I think you have to talk the talk but walk the walk. Walking the walk is in the compliance programs and in the controls. Did that answer your question?

COMMISSIONER NORRIS: Yeah, yeah. Thanks.

COMMISSIONER LA FLEUR: All right. Thank you, Commissioner Norris. I will try to keep us on schedule, but I have a couple of questions. Really everyone alluded in some way to making sure we are working on the right things.

We are putting our resources in the right places, priorities, some pretty compelling examples of maybe putting monitoring and compliance resources, things of less importance like something being in a Word document rather than an Excel spreadsheet or one in 10,000 fields not being filled out.

Assuming we could now figure out how to stop all that and now we have freed up the resources, what should we be doing more of? Whether it is NERC, FERC, or the Regional Entities, what are we not doing enough of, the things on the other end of the spectrum that
1 need more resources or more audits or more something
than they are getting now to help the system?

MR. CURRY: I don't know whether or not the forum is something that is applicable or possible for everyone, but certainly that is an exercise that is beneficial. It has been for LES, and we look forward to doing it with others. We have learned a lot from it. We also received some reinforcement of what we were doing, which is helpful. It is not always good just to be told where you failed. It is good sometimes to hear that that you are doing things well. I would encourage that.

COMMISSIONER LA FLEUR: I think Mr. Galloway made that point, rewarding the excellence as well. That is something that the forum is well situated to do.

MR. HAJOVSKY: If I may, a few things come to mind. First, guidance is always welcome whether it be with respect to process, with respect to interpretation. I interpreted your question to "we" being the Commission, so I will try to frame it in those terms.

COMMISSIONER LA FLEUR: It could be "we," the whole body of this working on this.

MR. HAJOVSKY: Yes, I understand. I understand. I will respectfully just offer two
thoughts for your consideration. Guidance is always welcome. I think participation in standards development is something I have heard at other settings, and then I guess sort of even tie it back to the guidance.

As we go through this next iteration of developing standards, we want to write them in a way that guides people not just for how reliability will be taking place, but how are we going to monitor the compliance.

This results-based standard concept is important because it gets to that point. It gives folks a clear definition for "How do I show what is going on," because the standards are written better.

But to the extent that the Commission -- well, not even with the results-based process -- feels that any deviation from an existing standard, unless it is in addition to, we would benefit from your participation because some standards may involve taking a fresh look at how we do things.

It is again kind of going back to some of my introductory remarks. Those are the two that come immediately to mind.

Thank you.

MR. GALLOWAY: I will speak kind of from
the ERO, the registered entity side. There are a couple of different things that kind of come to mind, assuming that we could prioritize the work a little differently.

One, I would see that much more effort being placed in looking at the health of the entity's compliance program, all right. Does it have, to Dan Skaar's point, all the right program elements? Is it well attended to by senior management? Is it yielding the right actions from staff? It is kind of a forward-looking item in terms of entity health and moving in the right direction.

This may seem to go a little bit in contrast to the consistency discussion, but I do think entity performance isn't equal, call right. I think that with a little more resource available, more up-front preparation in terms of getting ready to execute the audit in terms of really deeply understanding the entity's performance history, their culture, and so forth, and combine that with the higher-value standards to look at, I think we could do a little bit more of an informed look on the audits than we are doing right now where you are trying to cover a broad set of topics, and therefore
you are covering at maybe one level of depth that isn't appropriate.

Then, the other thing that we haven't talked about much at all is just really kind of working through training to make sure that all the folks in the ERO side understand process, understand application of standards, understand interpersonal action, and so forth.

What we do have -- my goal is for training of auditors, lead auditors, and so forth, but that could be taking the next level of detail down. Certainly there is training opportunity for other folks in the overall process as well. Those are some of the things that come to mind.

COMMISSIONER LA FLEUR: Thank you.

Mr. Skaar?

MR. SKAAR: I think one of the things is if we can take the mystery out of compliance I think that would be good, but by providing more details and what we call these "QRSAWs" in setting clear expectations.

I think that would go a long way to help in the industry and to be more constructive, because I do think compliance is more like kind of an open book test. You either did it or you didn't, and we
will figure out whether you did or didn't. I think that it is fair. I think that a registered entity should be encouraged to ask: "What are your expectations? What are the elements to demonstrate compliance?"

I think that is a fair question. I think it is an unfair question for Registered Entities to ask us: "If I do this, will I be compliant?" My response to that is: "Are you making a self-report?" (General laughter.)

COMMISSIONER LA FLEUR: Mr. Goodwill?

MR. GOODWILL: Commissioner La Fleur, I would offer, and I'm not sure that it is something that I think we need to do more, but one of the things that WECC has done now for the past couple of years is develop and expand its outreach to industry in the West.

I think that has been very, very successful through our compliance user group meetings, periodic open mike sessions where industry can call in and talk to WECC experts on the phone. We have used those forums to talk about lessons learned from our own compliance process, what our auditors are seeing at audit, the audit approach that they take, the types of evidence that
they look for, that they suggest that an entity
might want to think about having.

That necessarily gives the entities an
understanding of where really WECC is coming from in
interpreting the standards. As I discussed earlier,
I think the difficult we all have is in arriving at
a common interpretation.

We have tried as much as we can, and we
are continuing to improve our efforts, to pass on to
the entities what we believe the standards mean
without getting toward the official interpretations
that we know need to flow through a separate
process.

We have found a fairly steady decrease in
violations in the West over the past couple of
years. I am sure there are many reasons for it but
we attribute one of the major reasons for it to be
our outreach efforts. We are trying to take the
mystery out of what this thing called "compliance"
is and how we can work together to build the
Registered Entities' compliance, and therefore have
a positive effect on reliability.

COMMISSIONER LA FLEUR: Well, thank you.
I could ask followup questions on every single one,
but I see it is 2:45, and I want to keep us on
schedule because we have another excellent panel
coming up at 3 o'clock.

I want to thank the panel. I know this is
a dialogue that is definitely going to continue into
the next technical session and in between. Thank
you all and see you all back here at 3 o'clock.

(A recess was taken from 2:45 p.m. to
3:06 p.m.)

PANEL 2: VIOLATION PROCESSING AND PENALTIES

COMMISSIONER LA FLEUR: This afternoon we
are going to turn our attention to one of the more
difficult to talk about parts of compliance but
another important topic, "Violation Processing and
Penalties." We have an all-star lineup sitting
before us to talk about that.

I haven't prepared any little opening
remarks for this part, but I just want to read a
paragraph that our star lawyer, Jonathan First,
actually handed me that I had not previously focused
on in this way that is actually from back in
February 2006. The first order, 693, setting up
this whole schema, had just a one-paragraph on what
penalties are all about.

The Commission concurs that the
fundamental goal of mandatory enforceable
Reliability Standards and related enforcement programs is to promote behavior that supports and improves Bulk-Power System reliability.

"A monetary penalty must be assessed and structured in such a way that a user, owner, or operator does not consider its imposition simply as an economic choice or a cost of doing business. Further, a non-monetary penalty should be structured to encourage or require compliance and improve reliability. In its oversight role, the Commission plans to monitor the effectiveness of penalties, both monetary and non-monetary."

Here we are. Good work whoever was on the Commission. Commissioner Moeller and perhaps others were there, but that is exactly where we are as monitoring how that penalty schema is going.

We have, known to all, Gerry Cauley, the president and CEO of NERC; Stacy Dochoda, who runs one of the Regional Entities at the Southwest Power Pool; Bill Fehrman from MidAmerican Energy, the CEO and president there, thank you for coming out; David Mohre, the executive director of the Energy and Power Division of NRECA, the "National Rural Electric Co-Op Association"; John DeStasio, CEO of SMUD, the "Sacramento Municipal Utility District";
and Steve Naumann, vice president of Exelon.

I guess we will follow the same rules and start with
Mr. Cauley.

MR. CAULEY: Thank you, Commissioner La Fleur. Good afternoon, Chairman Wellinghoff, commissioners, staff, and fellow panelists. I was very intrigued by the questions and the discussion in the first panel. I was kind of wishing I had been up here.

I did think that most of the discussion centered around things that we have identified as areas we are working on and very consistent with our risk-based approach and some of the directions that we have recently taken. We will be submitting some comments, written comments, to that effect.

In the past three and a half years, NERC has made substantial progress in standing up a comprehensive program for monitoring, enforcing compliance with mandatory standards, working with 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 year since inception. Of these, 1,219 have been closed through filings of notices of penalty, 1,265 have been dismissed, and 3,003 remain open in the current caseload.

We have worked closely with the Commission's staff on what constitutes an adequate record for a violation. The Commission's of July 3d, 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 27th of this year further clarified the treatment of repeat violations. We understand what is expected by the Commission, and we continue learning and improving with regard to the record of violations. 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, as we
heard in the previous panel, have been publishing compliance application notices to further clarify expectations.

Most importantly, of the 4,222 possible violations that have been closed and made public are for more transparency to the industry with respect to what constitutes compliance. NERC and the regions, as we heard in the previous panel, have been publishing application notices to further clarify expectations.

Most importantly, of the 4,222 possible violations not dismissed over 2,700 or two-thirds of these 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 should improve reliability -- compliance results will improve
reliability of non-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 that this wave has crested and is beginning to subside.

We are currently experiencing a second wave of violations based on the cybersecurity standards. In fact, more than half of all incoming violations are related to cybersecurity.

I worry that this wave is still building and that even though cybersecurity is essential to reliability it may draw attention for more prevalent risks related to operating and planning.

In spite of the transitional nature of the caseload, I believe there are also underlying programmatic issues that need to be addressed. Most important is the tendency to treat every violation as being of equal importance to reliability.

The effectiveness of the compliance program depends on achieving proportionality between compliance efforts and benefits to reliability.

NERC and the regions working with the Commission
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 with a simplified format.

   NERC and the regions have worked together to align expectations regarding the quality and level of detail in filings. The amount of rework between NERC and the regions has been substantially reduced.

   We have a new initiative underway to treat the lowest priority of 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 a proposal and look forward to feedback on the initial filings of these administrative citations early in 2011.

   I would ask the Commission to consider over time whether there is sufficient trust in the program to allow NERC and the regions to exercise further 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 paragraph 225, which recognizes the enforcement discretion of NERC and the Regional Entities and the Order of April 19th, 2007, at paragraph 133 on delegation agreements.

Finally, I will note that the penalty sanction and guidelines, the NERC Penalty and Sanction Guidelines, which were modeled after the Commission's policies on enforcement, are entirely sufficient and appropriate in their current form to serve 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 do have a concern with our enforcement actions to date, 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 the Registered Entities; however, it is much more important to our reliability risk strategy
that we understand consistency of sanctions to mean consistent with the compliance behaviors to be encouraged or discouraged. I am more interested in penalties that send the right messages than the ones that send the same messages all the time.

In conclusion, I am proud of the progress that we have made in the developing the compliance program over the past several years. We have several great opportunities ahead to improve expediency, consistency, and reliability benefit. I thank you, and look forward to your questions.

COMMISSIONER LA FLEUR: Thank you, Mr. Cauley.

Ms. Dachoda?

MS. DOCHODA: Yes. I have slides, if we could cue up the computer, please. Thank you.

My name is Stacy Dochoda, and I am the general manager of the Southwest Power Pool Regional Entity. I would like to discuss a few of the accomplishments that I think we have had in the enforcement area.

I think we have achieved a better scalability of the penalties associated with the seriousness of the violation, and also I think we have achieved better guidance and have been able to
implement zero penalties where appropriate.

I think in the last year in particular we have reduced the rework that we have between the Regional Entities and NERC, and also we have increased resources substantially.

(PowerPoint presentation in progress.)

This graph shows the resources in terms of dollar budgets and also FTE's at the Regional Entity level and both of those have doubled since the 2008 time period.

In terms of our current environment, as Mr. Cauley mentioned, we are definitely seeing an increase in violations both in terms of the violations that come in, and unfortunately, because we are not processing them as fast as they come in, we are experiencing a significant increase in our backlog of violations.

This chart shows that while in 2008 we had a significant number of active violations, around 1,500 violations; today, we sit at 3,000. There are many reasons, I think, that lead to that.

I think that we have more experienced auditors. We have more resources that we are applying. We have also had more information sharing
in terms of best practices. Our processes have
improved. We have preaudit and more sampling that we do. Also, the number of standards has increased by 35 percent since we implemented the program, and that does include the CIP standards.

In addition, another item that I think may be a little more subtle is we have done a significant amount of outreach. Among the regions we have done 580 hours of face-to-face outreach to Registered Entities in 2010.

I think obviously that is an admirable thing and results in good outcomes, but it also does result in increased self-reports as entities understand what is required for compliance.

This chart is the one that keeps me up at night. As the Regional Entity general manager, one of my main responsibilities is to ensure that we have the appropriate resources to carry out the functions that we are delegated to do, and it is important to me that we are spending our resources where they matter.

What this chart shows is it shows the amount of our backlog that we would forecast under different scenarios at the SPP Regional Entity. The bottom lines of this chart are assuming varying processing speeds. A year ago at the SPP Regional
Entity, for each FTE that I had in enforcement we were able to process approximately six violations in one month -- excuse me, six violations in one year. We have doubled that production rate to where one person is now able to process about 12 violations in one year.

At the rate that violations are coming in to the SPP Regional Entity, which this year it was over 250 violations, if I don't change something significantly about the way that I process violations, by the end of 2013 I will have a backlog of 600 violations.

Now, you might ask me, "Well, you just need to increase your resources," but there are two reasons that I think that is not the right way to go. First of all, I currently have eight FTEs that I devote to auditing, and I have eight FTEs that I devote to enforcement.

In order to keep up with the rate of violations that come in, I would need to increase my enforcement by FTEs to 20. I think if I have an organization where I have 20 people in enforcement and 8 in the auditing team that there is something fundamentally wrong with what I am doing.

The next slide will expand on that a
little bit. This is a chart by violation risk factor, and the violations that I have processed or are in process. Eighty-one percent of the violations I have do not have a high risk factor.

Again, I think we have to make sure that we are spending our resources where they matter most. I think that will involve both streamlining processing, but I also think that we have to think about whether we should have more discretion in the field as to whether items are violations to begin with.

Finally, I am going to make a specific request. There have been several orders that have come from the Commission where we have received guidance on what the Commission would like to see in future notices of penalties.

I welcome that guidance, and we certainly plan to put that in place, but one of the logistic factors that we have to face is that at any given time we have about 500 violations that are in essentially final draft stage.

What I would like to request of the Commission is consideration such that when we have guidance about what should be in future NOPs that we are able to do that in a way that we don't have to
rework those violations that are already almost ready to come to you.

That concludes my remarks.

COMMISSIONER LA FLEUR: Thank you very much, and thanks for the specificity of that recommendation.

Mr. Fehrman?

MR. FEHRMAN: Thank you. Good afternoon, commissioners, I am Bill Fehrman president and COO of MidAmerican Energy Company. I will be speaking on behalf of both my company and my fellow CEOs of EEI member companies this afternoon and want to reinforce that we are committed to maintaining reliability, promoting a culture of compliance, and striving for operational excellence.

I am here this afternoon to offer EEI's perspective on how the Commission's, NERC's, and the industry's collective compliance and enforcement resources should be appropriately prioritized and allocated so we achieve our common goal of improving reliability in a more cost-effective fashion.

As the industry works on improving the electric reliability two essential elements are our strong compliance culture and a firm but fair enforcement.
The Commission, NERC, and the industry must strike the right balance between managing reliability risk and managing compliance risk. EEI is concerned that our priorities are out of balance, causing industry to collectively develop more resources to managing compliance risk than we do to identifying the priorities, the resources, and the incentives needed to manage reliability risks.

I would like to briefly describe what EEI believes are some of the symptoms of this problem and suggest some ways that the Commission, NERC, and industry must work together to strike the proper balance.

NERC has a significant and growing backlog of unprocessed violations as you have heard, many of which are highly unlikely to adversely impact reliability.

NERC also manages a compliance enforcement program on the premise that all violations must be equally addressed regardless of reliability risks and the facts and the surrounding circumstances.

The regions have no discretion in making threshold determinations on how to enforce a violation. The regions and NERC developed highly detailed records that that significant time and
resources to produce. Such time and resources could be better devoted to areas of greatest risk. After all no utility has unlimited resources, and all utilities should be cognizant of managing costs that will ultimately be borne by our customers.

To help address these issues, I offer two policy recommendations this afternoon for your consideration. First, the Commission and NERC need to agree on a clear set of common priorities for compliance enforcement and then allocate their enforcement resources and in turn our company resources where they matter most to the reliability of the Bulk-Electric System.

Toward that end, the Commission should allow NERC and the regions greater enforcement discretion. In addition, NERC should immediately develop a no action letter and speeding ticket proposal for minor administrative violations reasonably considered not to pose a significant threat to Bulk-Electric System reliability.

The Commission has clearly invited such proposals. Many violations driving the backlog are due to zero defect violations severity levels for violations that are unlikely to pose a significant threat to the Bulk-Electric System.
The process clearly needs changing when
the resource requirements for addressing an
inadequate system protection testing and monitoring
program, which is critical, are the same as for
missing a test by a few days as is the case today.

Second, EEI remains concerned that the
Commission is inadvertently supplanting the NERC
standards process by independently interpreting
standards through orders in some instances
significantly altering the requirements that
industry must meet.

The Commission should not misinterpret
this position as an unreasonable effort on
industry's part to avoid accountability. When
reasonable subject matter experts can disagree about
a standard definition, there should be no finding of
a violation.

Instead interpretation of standards should
in the first instance be made by NERC, and the NERC
Reliability Standards development process should be
leveraged to render interpretations promptly and
efficiently.

EEI members are committed to identifying,
prioritizing, and addressing any ambiguous standards
in need of further refinement as a part of the
broader NERC Reliability Standards development process.

Before I close, I would like to also update you on the status of our efforts to expand and strengthen the North American Transmission Forum, a topic that was also discussed at the July 6th technical conference.

As you know, the forum is a member-driven entity separate and apart from NERC. It's mission is to promote excellence in the reliable operation of the electric transmission system by cultivating and ensuring the expertise of its members who recognize that rules and standards alone do not ensure reliability.

Utilities can and should learn from each other's successes not just their failures, and the forum serves this precise purpose and is developing relevant metrics for a performance evaluation, developing best practices, and engaging in peer reviews.

Entities are increasingly recognizing the forum's value and it has now grown to 55 members, including our company. I would also like to note that since that conference there have been two EEI CEO meetings at which the forum was discussed in
detail. All of the EEI CEOs were briefed. I personally have attended the forum's board meeting this fall and will be attending the next forum board meeting.

Again, I appreciate the opportunity to be here today, and I look forward to participating in the discussion.

COMMISSIONER LA FLEUR: Thank you, Mr. Fehrman.

Mr. Mohre?

MR. MOHRE: Yes, thank you. Commissioner Wellinghoff -- Chairman Wellinghoff, excuse me, and members of the Commission, I want to introduce myself. I am David Mohre. I am executive director of the Energy and Power Division of NRECA.

As you are probably aware, NRECA's members supply retail power in all or parts of 83 percent of the counties in the United States. I will come back to that in a moment.

I would like to thank you very much for the invitation to come here and express our views on violation processing and penalties, but I would also even more like to thank you for continuing your outreach effort that you started in July. This is a very important issue to all of us, and I think this
outreach effort is very commendable.

At the outset, I would like to reinforce that the co-op strongly supported mandatory Reliability Standards before they were law, and continue to support that.

I would like to stress as I did in July that we think things are going pretty well, particularly when you look at the enormity and complexity of the issue, the evolution that we are undertaking, over the past few years.

We think we have a great view of what is going on across the country from the 47 states that our members serve. Importantly, we analyze how things are going from the following perspective that we continue to come back to over and over again.

Is the process producing focus on material issues? Is it a proper risk-based prioritization of effort? Is the effort timely? And, is the effort consistent?

Viewed through this lens we think many things are going very well except for something that has been talked about both in the last panel and this panel, and that is, it has become obvious to us and hopefully to everybody that we are making perhaps a continuing mistake if we continue to treat
all violations the same.

Whether it is a major or minor operation or maintenance violation or whether it is a documentation violation, treating them the same is a mistake. We are very happy with the efforts that NERC has undertaken to start down this path and the acceptance the Commission has shown in its writings, and we think that needs to continue with pace.

The reason we think that is important and the reason we think we must streamline the violation process and do it quickly -- and we don't care whether you call it a parking ticket, a traffic ticket, we don't care what you call it -- is the following.

First, if we continue to do what we are doing, as you have heard from this panel and other panels, you will continue to spend less time and focus on things that truly matter. You have heard it over and over again; we agree.

Second, we think we will continue to overload both NERC and RE staff and the RE and NERC processes in continuing to build backlogs that have a rather difficult kind of outcome.

Third, and this is fairly important and it is a little tough to talk about, we are afraid that
if we don't change some of this we will continue at
an effort that will raise questions in people's
minds of the ultimate usefulness of and the
motivation behind a lot of the process itself. I
discussed that a little bit in my written testimony.

It is interesting that 693 was mentioned
and particularly the part about encouraging positive
behavior. We fully agree, but I call to your
attention through analogy when is the last time you
put a quarter in a parking meter, you did the right
thing, walked away, and got a ticket?

The question is: Are you going to spend
the time and money to appeal that $25 ticket, okay,
and what happens when you get this over and over
again?

That is what has been happening to many of
our members. They have spent the time and effort,
they are told they do a good job, and then they get
dinged for some almost irrelevant thing that
couldn't affect the reliability of the Bulk-Power
System in any event. We think that is an important
issue.

I would particularly like to mention the
effect this kind of thing has with regard to the
smaller entities. The smaller entities were
mentioned earlier today. Again, it is the idea that
the fine is almost in many cases insignificant,
let's say it is $2,000 or $3,000, but in the view of
the entity that has been fined this was a mistake.
It was wrong.

   It is very expensive if you have to go
through a process, whether it is negotiation for a
settlement -- that takes legal time, it takes
technical staff time -- or go through due process at
FERC, NERC, and, God forbid, the courts.
   It is just an issue we wanted to bring up.
We think this has a lot to do with the idea of
speeding up and streamlining this process, and we
hope that you will consider what we say here.
Finally, we would like to say another
thing. Kudos, if you will, to our friends at NERC
for their efforts, recent efforts, with regard to
lessons learned analyses and getting that
information out. That is critically important to
improve reliability, and we think that is the most
important thing we do.

   With that, thank you very much.
COMMISSIONER LA FLEUR: Thank you,
Mr. Mohre.
Mr. DiStasio?
MR. DISTASIO: Thank you. Good afternoon, Chairman Wellinghoff and commissioners. Thank you for the opportunity to speak to you today. I am John DiStasio. I am the manager and the CEO of the Sacramento Municipal Utility District, "SMUD."

I am speaking today on behalf of SMUD but also on behalf of the Large Public Power Council, "LPPC." LPPC represents 24 of the largest municipal and state-owned utilities in the nation. The members are part of the public power community but represent the larger asset-owning members of the community.

Together LPPC members own approximately 90 percent of the transmission investment owned by non-federal public power entities in the United States.

The provision of reliable, reasonably priced, electric service is the core business of the LPPC. It is what we do. It is what our customers expect.

To better ensure that we can continue to meet this fundamental mission, LPPC supported the provisions of Section 215 of the Federal Power Act to make Reliability Standards mandatory nationwide.

Though we will always be looking for ways
to improve reliability, it bears no small emphasis that we currently operate an extremely reliable Bulk-Power System. This backdrop should not be overlooked when we consider issues related to enforcement and application of penalties.

I also believe that in determining penalties we must not lose sight of the fact that the Reliability Standards serve to prevent catastrophic or cascading impacts to the Bulk-Electric System, and enforcement should be tailored to focus on these types of events.

We will all be better served from a regulatory and enforcement regime that is specifically right sized to the risk. My remarks touch on the need to develop streamlined enforcement processes so that appropriate emphasis can be placed on those violations that pose the greatest risk to reliability.

I also want to discuss some changes that may be made in the application of the sanction guidelines to better ensure that potential penalties bear a reasonable relationship to the severity of the violations.

Finally, I would like to outline the importance of establishing an informal feedback loop
to clarify ambiguous standards and establish best practices for compliance in a manner that does not unreasonably penalize Registered Entities with a demonstrated intent to comply.

In the three years since the establishment of the mandatory Reliability Standards, the industry has devoted unprecedented time and resources on standards development and compliance.

In response to the Commission's policy statements, many companies like SMUD have developed robust internal compliance programs in order to monitor the increasing number of Reliability Standards and requirements. This heightened focus on reliability benefits us all.

While we have accomplished much in the past few years, we also face formidable challenges. In particular, LPPC has grown increasingly concerned with an enforcement and compliance process that though well-intentioned is more cumbersome and costly than it needs to be.

The sheer breadth and magnitude of the Reliability Standards makes perfect compliance impossible. Although great strides have been made in reducing the amount of outstanding violations waiting to be processed, the Regional Entities and
NERC continue to have compliance violation backlogs. Part of the backlog may be attributed to the number of self-reports being filed, especially with the recent implementation of the CIP standards. Significantly a large number of the violations are documentation related and pose minimal risk to the reliability of the Bulk-Power system. However, the current compliance regime gives too little recognition to the difference between violations that do not threaten system performance and those that do. This causes significant time and scarce resources to be squandered on inconsequential violations and diverts attention from addressing those violations that pose the real and significant reliability risks.

To resolve this problem, NERC and the Regional Entities must have the discretion to fast track those violations that pose a minimal risk to the reliability of the Bulk-Power System. LPPC supports the concept of a traffic ticket approach, as was mentioned before, under which these types of violations would be handled in an expedited fashion. This concept was discussed favorably in the Commission's order on NERC's
three-year assessment.

Other documentation-related violations that pose minimal risks to the Bulk-Power System should be handled through the application of baseline penalties in the order of a few thousand dollars. These baseline penalties could increase for repeat violations within a specified time period.

I also believe the Regional Entities should have the discretion to assess zero dollar penalties for self-reported violations that pose no or little or no risk to the Bulk-Power System.

The Commission expressed some concern in the three-year assessment that permitting a warning ticket mechanism would not require that sufficient attention be paid to a Regional Entity's compliance history.

An entity's compliance history is important, but NERC's current sanction guidelines by permitting penalties without fines only for first time violations and never afterward amounts to a zero-tolerance policy that in the long run is counterproductive.

I am confident that the industry participants can work successfully with NERC to
develop a means of tracking and punishing cumulative poor behavior without resorting to the unnecessarily inflexible approach of the current guidelines.

To ensure consistency within the regions, all baseline penalties should be developed jointly between the Regional Entities and NERC. NERC should also make a quarterly filing describing the types of violations that it handled through the expedited process instead of filing individual notices of penalty similar to what it does for omnibus filings. LPPC supports the expansion of a short-term settlement established by NERC and by the Regional Entities.

I would like to next address a few comments on the matter of proportionality of the potential penalties listed in the notice of alleged violations and the penalties that are ultimately assessed generally through settlement.

It has been LPPC's members' experience that there is often a huge chasm between potential penalties detailed in a NOAV and a settlement with a Regional Entity. That gap seems often to us to signify that the NOAV is out of proportion with what the Regional Entity reasonably believes the violation is worth.
The effect of the penalty stated in the NOAV can be quite damaging. This is especially true for a municipal utility seeking financing which must report the potential liability even if the ultimate result is not likely to be damaging.

The potential penalty may leave the utility with little choice but to enter into a settlement even if it generally believes it has acted appropriately.

Our experience has been that for one reason this lack of proportionality relates to the manner in which the duration of a violation is taken into account.

I should mention that I understand that NERC has an understanding that this matter of proportionality is something that reasonably should be addressed and that discussions are underway internally to come up with solutions.

I am not going to probably go a lot further because I think I am getting short on time. I just would like to add one additional point, and that is, in the past several months NERC has published lessons learned on its Web site.

I think we would reinforce the importance of transparency and communication. We want to work
to ensure that timely information regarding system events are circulated through the industry in a way that they can become preventative in nature so that others can learn from these experiences.

I would like to also press for an open line of communication between NERC, the Regional Entities, and the industry with respect to the interpretation of standards more like what occurs between Commission staff and industry partners.

We find oftentimes that while those discussions are non-binding, they are valuable as guidance for how to best comply with the orders of the Commission.

Finally, I want to close in commenting that I believe under Jerry Cauley's leadership NERC is looking for ways to address many of the concerns we are discussing today.

We believe that NERC is transitioning to an organization that understands not only the importance of vigorous enforcement where appropriate, but also a sense of proportionality between enforcement activity and penalties.

The key role of cooperation and communication between NERC, the Regional Entities, the industry, and FERC is improving reliability.
Thank you again for the opportunity to speak today, and I will look forward to your questions.

COMMISSIONER LA FLEUR: Thank you, Mr. DiStasio.

Finally, Mr. Naumann.

MR. NAUMANN: Good afternoon and thank you for inviting me to speak at this conference. I will discuss two topics, processing of violations and accounting for violations of affiliates.

In engineering school, I learned a formula: input minus output equals accumulation. That concept applies to filling a bathtub, to the concentration of carbon dioxide in the atmosphere, and to the processing of NERC violations.

Whether we call the difference between input and output caseload or backlog, there is an accumulation issue with NERC violations.

(PowerPoint presentation in progress.)

MR. NAUMANN: This chart shows the cumulative difference between the violations that come into the NERC process and those that are fully processed, and by that I mean those that are dismissed or filed with the Commission.

As you can see, there has been an
accumulation of over 1,100 violations since the 
October 2009 omnibus filing, and the trend is 
upward.

As you will recall, the purpose of the 
omnibus filing was to clear the backlog. The theory 
at that time was that the large number of violations 
that had accumulated as the compliance and 
enforcement program got its sea legs needed to be 
addressed so that the program could achieve a steady 
state.

But these data show that the program was 
not simply that the program was young. It was that 
the program needs to deal with the large number of 
self-reports that Regional Entities themselves 
detect in their review of compliance with new and 
sometimes ambiguous standards aided by what they 
learned from the filed notices of violations and 
from NERC's compliance analysis reports.

There needs to be a process change. The 
Commission recognized this and indicated that it 
would be appropriate to develop a parking ticket or 
speeding ticket approach for minor violations as 
well as appropriate procedures for resolving purely 
documentation-related violations. These processes 
need to be developed now.
At the recent NERC Board of Trustees Compliance Committee meeting, there was extensive discussion as to how to implement a proposed administrative citation process.

Questions on whether repeated violations could be included, whether this was restricted to new violations, and what "minimal risk to the Bulk-Electric System" means were discussed.

While it appears that NERC is making progress, these issues have not yet been resolved. It seems that in the debate to ensure that this process is strictly limited to only those violations that will have a minimal risk to the Bulk-Electric System, implementation is being delayed.

In my opinion, NERC can do this, and the Commission should allow NERC to make it happen with the goal of implementing this administrative citation process by January 1st, 2011.

If there are imperfections, the process can be adjusted along the way. There is no need for micromanaging the process up front to ensure perfection. Every month's delay means an accumulation of several hundred more violations.

Another source of the accumulation is the input, and you heard a little bit about that in the
first panel. Certainly, it is incumbent on the industry to comply with the standards, but as the Commission knows there are ambiguities in the standards. Beyond that, there are interpretations of what proof is needed for compliance.

Hypertechnical interpretation of subjective words can unnecessarily add to the input stream of violations. For example, Requirement 1.2 of CIP 003 requires the cybersecurity policy to be "readily available."

If this is interpreted in an unreasonable and subjective manner, individual audit teams' ideas of what "readily available" means can increase the violation streak. Does this really improve reliability?

Finally, on the subject of repeated violations as applied to affiliates, I would ask the Commission to understand that what may appear to be different and thus repeated violations by affiliates are often actually the same violation that was uncovered as part of a corporatewide extent of condition analysis based on discovery of a violation in one of the affiliated entities.

If these violations are uncovered as part of a corporate-wide analysis, they should not be
considered multiple violations or an aggregating factor that increases penalties rather NERC, the Regional Entities, and the Commission should support such actions as a step toward increasing reliability in an efficient manner.

The fact that some organizations have many affiliated entities should not result in worse treatment than if they were organized into a single integrated entity registered with NERC as one registered entity.

Thank you and I welcome any questions.

COMMISSIONER LA FLEUR: Well, thank you very much, Mr. Naumann.

Pretty clear messages coming from all of you, and I guess it is our turn to respond, starting with the Chairman.

CHAIRMAN WELLINGHOFF: Do we have a theme here?

(General laughter.)

CHAIRMAN WELLINGHOFF: I guess, Gerry, you are on the hot seat. The question of the hour is: How fast can we put the traffic ticket system in place? What have we got to do to get there? How can we as a Commission or our staff help you do that? What can we do to move there?
Because everybody wants to move there. I think my fellow commissioners do, and I certainly do. We all recognize that that is one thing we need to do, as was so aptly stated by a number of panelists here, that we need to set up a system where we don't treat all violations the same, that we have got some kind of a more functionally and administratively easy process that can be used for these lower-level violations so we can stop all of the resources going each one of these things even though they shouldn't all be treated equally.

What do we need to do to get there by, as I think was suggested by Mr. Naumann, January 1st, 2011?

MR. CAULEY: Thank you, Mr. Chairman. We are shooting for January but not the first.

CHAIRMAN WELLINGHOFF: Of 2011, though?

(General laughter.)

MR. CAULEY: Of 2011.

CHAIRMAN WELLINGHOFF: Because we know also we have to define our terms here. We have been told that.

MR. CAULEY: There has been a long history on trying to get the record and the workload for violations skinnyed down to being appropriate. It
was probably a year and a half ago we first launched
a program to come up with a short-form settlement.

By the time we finished all of the
negotiations about what the criteria and when would
it work and how would it fit and how would it be
used, the short form wasn't really very short.

We had another effort which I think was
more successful this year, which was the abbreviated
NOP, which basically puts the filing of the record
in a standardized format. It is sort of fill out
the box. It is easier to get to, and it is a little
quicker.

I have always through that whole process
thought that for some of the simplest violations,
the record should fit on one piece of paper, one
sheet. I have not given up on that goal.

We have had some discussions with the
enforcement staff and the reliability staff here,
and I think we have an agreement on what this
administrative citation looks like.

We are looking to bring a number of those,
probably on the order of close to a hundred but I
don't want to quote that number exactly, a good
number of them to our Board's Compliance Committee
meeting in January and file them shortly after that.
We are ramping this up. I think it is very promising if this takes, and we do certainly need the Commission's help on this in terms of did we get it right.

My judgment, without also not holding me to numbers but my intuitive instinct, is that we should be able to treat half of our violations with this one-page citation.

CHAIRMAN WELLINGHOFF: I will certainly commit to you our support in any way possible and turnaround as quickly as possible either from the Commission and/or our staff to get this process in place because I think we are all anxiously, obviously, awaiting this.

The only other area I have is just a comment on, Mr. Fehrman, some of the things you talked about on the North American Transmission Forum. I am glad for the update and the information you provided.

I am very supportive, as Commissioner Moeller mentioned with the last panel, of this new process. Anything we can do as a Commission to support you and our staff with respect to that effort on the North American Transmission Forum, please let us know.
MR. FEHRMAN: Yes, thank you, Mr. Chairman. The forum held a very comprehensive strategic planning session just a couple of weeks ago on how to move the forum further along in the good things that they already do.

With the Commission's help and support, I think that the forum will really pay off dividends as time goes on. We are excited that, including ourself, more of the industry has become involved in the forum. In fact, just over the past couple of months, the membership has grown significantly.

CHAIRMAN WELLINGHOFF: I notice you have some interesting sort of anomalies in your membership. You don't have a lot of people in the West for some reason. Is there some reason for that?

MR. FEHRMAN: I am not sure. PacifiCorp just joined as a part of us.

CHAIRMAN WELLINGHOFF: Oh, they did? Okay, so that is going to take care of it, okay.

MR. FEHRMAN: Absolutely. That fundamentally takes care of the West.

(General laughter.)

CHAIRMAN WELLINGHOFF: There are a few other folks, Arizona and New Mexico.
MR. FEHRMAN: The part of the West that I care about.

COMMISSIONER LA FLEUR: PacifiCorp has a big chunk of that upper Northwest section.

MR. FEHRMAN: Yes.

CHAIRMAN WELLINGHOFF: That is very true.

Well, thank you for that information.

Thank you, Commissioner La Fleur. I don't have anything further.

COMMISSIONER LA FLEUR: Thank you.

Commissioner Moeller?

COMMISSIONER MOELLER: Thank you, Commissioner.

I have spent time with all of you, sometimes significant time, over the last few years dealing with these issues. Again, a great panel.

Thank you for being here.

I won't beat the horse too much more.

Stacy, first of all, than you for hosting me and Rob Ivanauskas of my staff in Little Rock in September. I think you are getting Commissioner La Fleur there, too, for one of your quarterly Regional Entities stakeholder meetings.

Although I was asked some difficult questions, I appreciated the chance to be there. I
don't know if all the RE's do that, but it certainly
seemed like a good forum to air concerns of the
entities within the RE.

Did I hear you right that of your staff
allocation essentially it takes a person on average
-- they go through 12 a year of violations?

MS. DOCHODA: Currently, that is correct.

COMMISSIONER MOELLER: Essentially, that
is on average a month's time per violation?

MS. DOCHODA: That is correct.

COMMISSIONER MOELLER: That is some
significant cost even just for you, not just the
entity. Even if it is a zero-dollar violation,
there is still a lot of cost involved there.

MS. DOCHODA: Right. I guess I would add
to that that at least in the early days I think
sometimes it took more to process a zero-dollar
penalty than a non-zero dollar penalty because we
had to justify it in more detail.

Even though we have made significant
strides, as Mr. Cauley referred to, this past year
the processes have improved quite a bit. bit it is
just at the rate that it is coming in, it is as if
we have a fire outside and we have brought out a cup
of water to it. We are going to have to approach it
in a more expeditious way.

I think the administrative citation suggestion is one that I am very excited about. I think that it could be that step change that we need, but I will make one comment.

As it is currently devised, the suggestion is that it would require that the registered entity admit to the violation.

There is a processing issue that I struggle with there, and that is, if the entity admits to the violation at the Regional Entity level but that is not yet a final determination as to whether the penalty is going to be accepted, and then it goes to NERC or FERC and is changed, I think it could be really difficult for us to process the number of violations we would like to process, if we do require an admission at that NS process. I think I would like to see us consider a neither admit nor deny or a no contest type of approach.

COMMISSIONER MOELLER: Okay. Thank you.

Well, again, I appreciate all of your testimony, the detailed nature of it, and the fact that you are here today.

COMMISSIONER LA FLEUR: Thank you.
COMMISSIONER SPITZER: Thank you.

Certainly I am not one to break the consensus on this concept of bifurcation with respect to severity so the resources go where there is a potential for harm and not where the effect on our liability is trivial.

Let me share with you maybe a conceptual framework because the devil is in the details is at going to be drawing that line.

You have got the subsidiary issue, which I think is very significant you raised, Stacy, with respect to the admission of a violation which not just with public entities, but, as Mr. DiStasio pointed out with municipal, may carry some economic, political, or other consequences attached to an admission of any type may be problematic.

In some discussions I had with my own legal advisors, and I shared the discussion I believe with Mr. Bay of enforcement and with my colleagues, which is a conceptual distinction between an "amnesty" and "forbearance." They are very different considerations.

An "amnesty" is a recognition of wrongful conduct, but for reasons either of government efficiency or cost savings or simply we don't want
to be bothered, there is a declaration that
notwithstanding the wrongful conduct we are going to
absolve culpability.

The second is "forbearance," which is a
different concept, which is there may have been a
violation but for reasons not of simply convenience,
and this is what I think you are getting to when
you, David, said "We don't want to impose penalties
where the issue was, I think you used the word,
"trivial."

A triviality is subject and appropriate
for forbearance. That is a very different concept
than an amnesty. Maybe this is helpful, maybe not,
but I would like the reactions.

At some point if we are going to implement
the proposal, Mr. Cauley, with the support of the
stakeholders and with the support of the Commission,
it is going to have to, I think, end up on the side
of which of these notices of penalty -- let's start
with the self-reports, just for the sake of
argument, self-reporting, as opposed to an audit
finding.

Which self-reports are those where the
government and the ERO ought to forebear from
further action as opposed to an amnesty? I don't
think that is what you intend. How would you maybe respond to this demarcation line?

MR. CAULEY: That is a very good question, Commissioner Spitzer. A principle we are trying to get to is how do we reinforce the right behaviors. I think on the first panel there was a suggestion about the proper effective controls because we are all about trying to fix things and improve reliability.

I look at the case where the entity has the reverse program and is self-assessing and self-reports. In some cases, the volume of those self-reports is repeated, but it is because of a good program.

In MISCE I want to reward good strong controls and a good ethic in terms of self-reporting, and that seems to be lining up with your definition of forbearance.

I want to send positive signals, and I want to send them widely so other people get the same message and start acting with those same behaviors.

COMMISSIONER SPITZER: An amnesty of course is the absence of a sanction or the exculpation of wrongful conduct not connected with
internal controls, but because government is too busy?

MR. CAULEY: I think my opinion is we don't really need amnesty, per se, but we need what I just described as a concept of forbearance in terms of rewarding positive behaviors.

The other thing we need to do is just prioritize our work and our activities. If we have 3,000 things we are going after, it seems like we should be prosecuting the ones that are most important.

Maybe three years from now, when all of the big things are taken care of, we will be looking at a different level of things, which not to me is amnesty, but it is which ones are we going to pursue now in front of us to help prioritize some of the work. It doesn't mean you are off the hook forever, but it means I have bigger fish to fry right now in terms of improving reliability.

COMMISSIONER SPITZER: Any other reactions to this? Dave?

MR. MOHRE: I don't usually negotiate with myself.

(General laughter.)

MR. MOHRE: I think I agree with Gerry on
the forbearance for actually another reason.
Although the issue of repeated trivial violations is
a tough one sometimes, you can have people of bad
attitude that keep doing the same trivial things
over and over again, and forbearance makes sense
there and that can accumulate to something
significant, if you catch my drift. If you have
amnesty, of course you wouldn't have that.

COMMISSIONER SPITZER: Yes.

MR. MOHRE: I would just like to add to
the point of self-reporting I think the way we have
approached that is that is that is a way for us to
demonstrate a culture of compliance by providing a
certain evidence of rigor for our own self-audits.
In fact, I think it is important that that
continues.

Now, obviously if an entity were to
continue to self-report the same type of thing over
and over, it might end up having a diminishing
benefit.

But I do think that having rigorous
self-reporting by the Registered Entities I think is
important and should be encouraged because it is a
key part of our learning to have that information
out there.
MS. DOCHODA: I would just like to add that I think the importance of mitigation is also something we have to incorporate into whether it is forbearance or amnesty. I always want to close whatever gap there is, so I really want to concentrate my effort on the mitigation and bring that into play.

To me for an example of a category that could fit into either of these, I think we have a number of standards where just from what I can see in the field there is a lack of understanding about what is required. What is the difference between an "incident plan" and a "recovery plan"?

When you see common things that company after company have struggled with to be able to get exactly right, I think that the most important thing is that they take their plans and get them right. But to assess violations on them when they are so common, I think is not particularly productive.

MR. MOHRE: Okay. I guess one more issue to raise is this question of in one of the topics: "Do the current -- processes provide approaches and improve reliability by reducing future Reliability Standard violations and system disturbances."

To me that is original entities have cases
that come before them, and so an awful lot of time
is spent putting out fires. The utilities, you have
matters that come before you, and it is putting out
fires.

What collectively can we do to engage in
the long-term thinking and planning necessary to be
proactive in light of the pressure that we are all
under with regard to putting out fires on a daily
basis? It is a challenge to us all really.

I will try that first, if I may. I think
that David mentioned something that really resonates
with me early in his comments, and that is, that to
the degree that we are spending a lot of time or
working with the entities on very trivial matters, I
do think it hurts our credibility in terms of what
we are really trying to accomplish.

I think to the degree that we are really
working with Regional Entities and we are focusing
on the things that really impact their liability, I
think that that will also enhance our ability to
work with those entities to improve reliability
going forward whether it is an event analysis or
other assessments that we do with the entities.

COMMISSIONER SPITZER: Steve?

MR. NAUMANN: I think there are two
things. First, to take a step back and prioritize which things are really, really important to the reliability of the Bulk-Electric System.

As I think we heard this morning, if you had a list of eight, very quickly we could probably agree on the first five or six without much argument and maybe a little disagreement on the bottom two. Because that is where the emphasis should be.

The second is education. Under Gerry's leadership, that has started to turn around. But from my view in the industry, it is not happening fast enough. That may well be because the input stream is coming in pretty fast.

There are, I don't know, about seven or eight of these compliance analysis reports to date, and there are a lot more standards out there than seven or eight.

They kind of need to get ahead of the curve. That is difficult because you have a plan and then now all of a sudden the CIP standards are coming and you have got to kind of turn on a dime and say, "Well, I've got to analyze those."

I think more information, more analysis, and a deeper dive into what the real problem is, and the real problem is not necessarily the fever, for
example, it is what is causing the fever. That is a change in emphasis. I know Gerry has only been on the job 11 months, and it takes a little time to get there, but I think you need to do that. The same thing with the event analysis reports.

Again, that is now going through a change in process, but we in the industry have clearly not been seeing that in any kind of timely manner. There are reasons we have been told that they are confidential, there is confidential information in them, we can't see them, they are protected, they contain critical energy infrastructure information. Well, we deal with critical infrastructure information all the time, so I find it hard to understand why our people who have some of the most confidential data to understand on their own what has happened. There are some of these events that are three years old that we still do not have the reports. Again, I think that is changing with the new processes, but the more info we get about what the problems are, we can take action on that. That is the real improvement in reliability.

COMMISSIONER SPITZER: I would agree that Mr. Cauley is moving away from the putting out of fires to long-range planning that is what is needed.
I thank you for that.

Thank you.

COMMISSIONER LA FLEUR: Thank you.

Commissioner Norris?

COMMISSIONER NORRIS: A followup to what Commissioner Spitzer was talking about and several of the commissioners with regard to the no action letter or the traffic ticket.

I probably shouldn't ask this I know. In those submissions of self-reports or even someone who has been called for a violation, do they ever request to submit their own recommendations for a penalty?

MR. CAULEY: Well, I think in most cases the entity does submit their own recommendation, but usually there is some negotiation and haggling, because it is pretty much a settlement process.

The vast majority of our violations are treated through settlements. Typically, the region will come in with a proposal and the entity will have a proposal, then there will be some negotiation.

COMMISSIONER NORRIS: The entities will generally propose it first?

MR. CAULEY: Yes. I think in the
administrative citation I wouldn't rule out that that is there, but what we want to avoid is an extended months' long negotiation over that, because it sort of defeats the purpose.

As long as it was an expedited discussion, I think that would be -- my sense is I worked in a region for a while, and we are always willing to listen and hear proposals and issues and things like that, so I think that would still continue.

MR. NAUMANN: Just in our experience and maybe in different regions, the region proposes a penalty first and then the entity responds to that.

COMMISSIONER NORRIS: Okay. I am just curious. Sometimes asking someone to propose the penalty gives you some sense of their recognition, or lack thereof of, of the severity of the violation. If that is a shortcut to getting the resolution, perhaps it is one to think about.

Mr. DiStasio, you mentioned that you had some concerns about the NERC Sanctioning Guidelines. I am just curious about if you have, you or any of the other panelists have, other thoughts or ideas on additional changes or how to make them work better?

MR. DISTASIO: I think one of the things that we have experienced I think in discussions with
my colleagues that have had similar circumstances
where the sanction guidelines apply to penalties on
a day-to-day basis until there is a mitigation
completed.

We could have a circumstance where we may
have missed a reporting requirement by five minutes.
We have a daily load report, and we have to report
that every day. If we miss it one time for five
minutes and we are compliant every day thereafter,
but the clock continues to run, the sanction
guidelines end up getting applied in the totality of
that whole time until the mitigation is completed,
which could be a significant number.

It might be material enough in some cases,
as I mentioned, that we would have to disclose that
if we were in the midst of a financing or something
even though at the end of the process it may
ultimately be a very small amount we ultimately end
up getting assessed.

The application of the sanction
guidelines, I think we just need to take a look at
how those get complied initially, because sometimes
in our case we have found they don't bear a
significant resemblance to what we ultimately end up
paying on that issue even if it doesn't go through
MR. NAUMANN: I think a tangible example would be you have a system protection device that is supposed to be tested on a five-year interval, and we are now over a thousand days past June 18th, 2007.

If it were to come up now and with a minimum fine of $3,000 a day, you are facing for one device a possible fine of $3 million because it has been unmitigated for a thousand days. One can argue whether the system has been really in danger $3 million worth, but I think that is the kind of thing that is a concern.

MR. CAULEY: Thank you, Commissioner. The per-day accumulation is something that was clearly directed by the Commission and it is sort of part of the thinking in the background, but I think in every instance that I am aware of there is a lot of pragmatism and realism applied to that. It is not that we just take $3,000 and multiply it by 550 days.

If there are instances where somebody is providing the maximum credible numbers as the number put on the table, I would like to hear those case because I don't think that would be consistent with
our approach. The approach that we have would be
that the regions and anyone in negotiation should
put down their realistic number in terms of what the
value of that penalty should be as an initial
proposal but not maximum theoretical for the very
reasons that we heard today.

If we were being impractical about this, we would have had a lot more $5 million,
$10 million, $30 million penalties by now. The
larger numbers are very rare, and I think that is an
indication of the realistic and pragmatic approaches
being taken in the regions. We will look into it,
but if there are cases, we would like to know about
that.

COMMISSIONER NORRIS: Thank you.

COMMISSIONER LA FLEUR: Thank you very
much.

Well, I have a couple of questions that
are somewhat broad. A lot of the theme of what
everyone has said has really kind of revolved around
work on the big things, less on the little things
with which it is impossible to disagree. In fact, I
have made no secret I think we need to focus on our
priorities in this process.

Just to kind of push at that for a minute,
there is a well-known phenomenon. I am sure a lot
of you are aware of the "safety pyramid" where there
is, say, like an occupational safety. For every so
many times you do a little thing wrong, a big thing
is going to happen.

    For every time you don't wear your
seatbelt, one in every so many times there will be a
fatality or whatever. This is the same phenomenon
Commissioner Spitzer was talking about, the people
who have terrible documentation and maybe other
things are wrong, too.

    Obviously to make the system work, we are
going to have to batch the process and streamline.
It is obvious from the figures, but is there some
way that we can get lessons from those little things
or from leading indicators that might not be the top
five things that Steve Naumann talked about?

    Is there some way we can get the lessons
of whether there is a -- I don't know whether it is
a system audit where you look at the overall how a
compliance system is going or whether you do
trending, so we don't just in our focusing on the
big things lose stuff that might prevent a big thing
in the future? It is a pretty general question, but
I would appreciate any thoughts.
MR. FEHRMAN: I appreciate the question, Commissioner. I think that I spent a considerable amount of my career in the nuclear power industry, and the issue you just raised is exactly why the nuclear power industry continues to get safer and safer every year.

The problem identification and resolution process, which is the underlying foundation of everything you just talked about, is really what gets focused on when auditors come in from either MPO or from NRC.

We spend a considerable amount of time in this forum and other forums talking about the sanctions and the other amount of money, and I don't think spend a fair amount of time talking about the underlying process that needs to be put into place at utilities such that it forms a very robust mechanism for identifying what the problems are and then correcting them.

To your point exactly, particularly in the nuclear power field, as you look at trends through the problem identification and resolution process, you will find those things that will continue to pop up and drive you to make risk-based decisions.

I think the same applies to this business
of reliability. When we look at opportunities for
developing processes and procedures, it would be my
hope that we spend a lot more time when people come
see us challenging the veracity of my problem
identification and resolution.

That is where when I find issues I report
them and identify them, and you look at those to
decide whether or not they really should have been
reported.

NRC has a very comprehensive way of
putting the severity on an issue. I just think
there is a lot to learn from that that has reaped
benefits over time that can be applied in this area
and do exactly what it is you are hoping and asking
us to do.

COMMISSIONER LA FLEUR: Thank you.

MR. CAULEY: Yes, Commissioner, I also
came out of the nuclear industry, and I think
perhaps that is sort of what drives the vision of
where we are trying to get in terms of risk-based
and fixing and correcting things because I ascribe
to that same thinking.

But I think your point, we have heard a
lot today about important standards and unimportant
violations and important violations, the approach we
need to take is really a defense in depth and preventive barriers to bad things happening.

I don't write off entirely that some little violations, they can be symptoms of things. They can be symptoms of larger things. They can be symptoms of breakdowns in checks and balances of controls. We need to get the response proportionate. We need to be able to read the signs of what is this telling us and then take corrective action.

I go back to the point earlier as if we could establish good measures of: What is a good system of controls, checks and controls, to make sure that things are being identified and corrected and made non-repeatable to the extent we can?

At some companies, you have a standard and you maintain your relay and document it in a certain way. But if you have 25,000 of those, statistically it is impossible to not to have an error.

But if you have a very robust program for measuring and capturing those things, and you have a way to capture even the most minor discretion in terms of whether their signature was a day late or not and be able to correct that and sort of loop back and fix that, those are really strong programs
that we need to build off of.

   The other area that a couple of people
mentioned, a couple of panelists mentioned, is the
Event Analysis Program. It is new. If I could have
written it myself, it would have been out back in
March, but it has taken a lot of work and
consensus-building and getting buy in from the
industry.

   I think it is going to be a cornerstone of
getting us focused on the important things, because
we are going to look at events, why they are
happening, do the root cause, and bubble that back
into what can we do to fix the standard, what things
will be focused on in compliance.

   Are the barriers we think we have in place
from catastrophes happening, are they really
working, or are they not working? How do we really
fix that? We are depending on the industry to not
be a victim in this, but to be a participant and
part of the process to help us get there.

   I think it is a very similar model that
has worked well in the safety record in the nuclear
arena for the last 15 years, and we are going to
emulate that.

   COMMISSIONER LA FLEUR: Thank you for
those very thoughtful answers. I mean, again, I am not saying that every little documentation has to treated like a big vegetation management problem that leads to an enormous outage, but somehow we can't lose in whatever process we design, lose those lessons that you can get from the trending just as you both spoke of.

I am kind of debating with myself whether to ask my last question, but I can't resist because of the expertise I see sitting out there. You kind of teased it up with your last reference to "event analysis" because it has kind of been in the back of my mind.  

There is kind of an old saying that "What is good about something and what is bad about something is always the same."

What is so great about our reliability process is how broad-based it is, and how much buying you have, and how everything goes to so many sectors and gets debated, gets vetted, then gets voted and revoted, and comes to the Commission where we consider it carefully and do it so enormously comprehensively and all.

But that is is one of the challenges of the program is just how long it takes to get
standards out or get the new traffic ticket design, system designer, get the event analysis out the door.

Without losing the input, I mean, is there anything -- you guys have been at this a long time -- that we can do to make this faster? I mean, is the forum the answer? Go behind closed doors and get it done? Or, is there an answer that we can start helping with? Just an easy question at 4 o'clock in the afternoon.

(General laughter.)

MR. CAULEY: Yes, it is an easy question I will take. Well, first off, I have been doing consensus or consensus type things at EPRI and NERC and the region. I have been doing that kind of thing for 25 years.

I actually feel there is a tremendous value in getting consensus through a broad-based process. It is tougher, and it is more challenging, but at the same time, almost every hard thing I wanted to do in my career I think got done. Sometimes it is harder, and it just takes longer.

My particular frustration now is in the standards, in getting those moved along. I am ready at this point to say maybe we need to relook at how
we do the process, that maybe we do take standards
crafting offline in some process where it is open
and experts can get involved, but we don't encumber
the whole development process through our comments,
bballoting, iterations, and so on, and save that for
the end where all the stakeholders get their vote.

They all have to be able to comment. They
all have to be able to. I think we need to look at
different ways to break through out of the box just
different ways to think about how we do things.

Also, I want to try to loop back to a
prior comment, but in the regions, the resourcing
and getting the work done, we started out thinking
every violation had to be a negotiation and
settlement of a contract.

If one little signature was missing, a
zero-dollar or a $1,000 penalty we devote months of
lawyers and technical staff to produce a $1,000
contract.

We have to break out of that mentality and
that cycle and start thinking about not just the
administrative citation, but how do we just rethink
our work, and how do we get things done.

My answer is yes and no. Yes, I do
relish the input and the due process, but in certain
areas we have got to break down some of these
barriers and get moving.

COMMISSIONER LA FLEUR: Mr. Naumann has
the answer.

(General laughter.)

MR. NAUMANN: No, I don't. Well, I don't.
Obviously, it's pretty hard to have the answer.
Coming back to this panel on compliance and
enforcement, I think NERC needs a little bit of room
to make mistakes.

We all make mistakes. We are not perfect.
NERC may send up out of 400 violations 2 that
somebody in retrospect says shouldn't have used the
short form.

The response shouldn't be the hammer that
"You did it wrong" because I think as Stacy said you
get a directive and now the 400 others that are
almost at the end of the process have to all be
looked at one by one. That, to use the bathtub
analogy, puts the stopper in the bathtub and you now
have the accumulation.

NERC should have the feeling that they can
be almost perfect. But if there is something that
there is a reasonable disagreement with, that it can
be handled in a different way.
Because I think the standard still is when it comes up in reliability, it is still just and reasonable. Reasonable, I don't think there is one definition -- in law school, the judge gives the charge to the jury of a "reasonable person," and the jurors ask, "What does that mean?" A reasonable person is a reasonable person.

I think to give them a little leeway, I think they will come to right answer. As we all acknowledge, the jury has got a new team in place. They have made progress in a number of areas, and I think that is how they could be supported in the compliance and enforcement program.

MR. FEHRMAN: I would like to touch on the forum very briefly. First of all, I think the forum prior to it becoming very relevant was doing outstanding work, albeit they were doing it amongst the utilities that were in there, and the programs and processes that they had were very robust.

Since a few months ago, the relevance of the forum has grown tremendously, and people see the value of the forum. I give Gerry credit. He has shown tremendous leadership with regards to trying to bring the forum and NERC together.

In fact, I was at a meeting where Gerry
basically stood up in front of the board of the forum and said, "Tell me all of your issues, and let's work on them." That is a very positive, a very powerful message for Gerry to do and come to the forum.

Specifically to your specific question, I think that as the forum grows in its relevance the fact that the membership of the forum now is getting to be such a broad base that using it as a way to vet a number of these things I think will become more and more possible and will occur over a period of time as it matures.

I think that having that will save a lot of time and effort because arguments can be done there, and then hopefully from there it can transcend into the NERC process.

Whether it stays the same or if Gerry modifies it in some way, I think that having that ability will be very powerful for the industry to use.

MR. DISTASIO: I was just going to just add on to that. I know several of the LPPC members are part of the forum, including Los Angeles in the West as well.

I know for me I think education and the
more that we can have the ability to talk about
tings that increase a common understanding of what
is necessary to be compliant and to improve our
pliance over time, I think that is going to be
helpful.

I mean, I think the compliance action
otices are helpful and the event analyses are
helpful, but sometimes those are corrective after
the fact.

We need to have places where we can
ommunicate in advance. Without undermining the
pliance efforts, we need to have places where we
can talk about what should best practice look like.

Then, the only other thing I would say is
we are taking responsibility from the industry.
LPPC has just finalized an action plan to get
greater CEO engagement in the balloting process, so
that in standards development we take some
responsibility to move those along with our staffs,
because believe it or not we have sometimes a fair
mount of disagreement amongst technical people even
within our own organization. We need to do a better
job pulling that together. We have made a
commitment on LPPC's behalf to do that.

COMMISSIONER LA FLEUR: Thank you.
Mr. Mohre?

MR. MOHRE: I feel compelled at this point to just mention a couple of things. One is and certainly -- how do I say this? The consensus process as Gerry described is sometimes slow, slower than we would like it to be, but it is also very, very useful and productive in that sense that it allows time for industry buy in of both the process and the product.

Also, I don't want to get into -- I have to say it straight out. It also is sort of consistent. If you read the legislative history of 215, you will see it right there, okay, the industry (chuckling), the expertise of the industry balanced with the FERC approval process and ultimate authority there and balanced with the ERO.

It is important that we keep in the back of our minds that that buy in takes some time, but is very important and is consistent with at least the legislative history and I think the plain meaning.

But it is also true when we need to do something quick, we have a FERC-approved process called the "urgent action process" that will allow standards to be developed very, very quickly. There
is also an immediate process.

Gerry, I have forgotten the name of it.

God help me. I will be punished.

There are processes to do it. Can we find ways to facilitate this? Sure, we can find ways to do that, but I also think we have to remember some of these foundational issues, too.

Thank you.

COMMISSIONER LA FLEUR: Well, thank you for all those comments. I certainly take your point on the legislative history. We are just trying to, I think, all of us find ways to uphold the purpose of the legislation, which at bottom was reliability in the best way that we can.

With that, I think I have asked enough questions. We will go to closing statements.

Mr. Wellinghoff?

CHAIRMAN WELLINGHOFF: I want to just thank all of the panelists on this panel and the earlier panel as well. The willingness of everybody --

MR. BAY: Excuse me, Mr. Chairman. I think this is actually time for questions from the audience.

CHAIRMAN WELLINGHOFF: Okay. We can do
COMMISSIONER LA FLEUR: Sorry, Norman, I screwed up my thing. Okay. I guess now we are going to do the questions from the audience. I'm sorry.

THOMAS POPICK: Hello. My name is Thomas Popick (phonetic). I come here today as a member of the public. I represent only myself. I don't work for the electric power industry.

I have already been cautioned that my question today might be inappropriate, but I would just like to say if this really is open to the public, I think we need to able to ask questions.

My question is what the electric power industry is doing to protect against catastrophic events like solar flares. I want to say at the outset I would like to express my appreciation for what the commissioners recently did in releasing a report about so-called high-impact, low-frequency events.

My understanding is that events of this kind could collapse the North American power Grids and could result in the end of the United States as a nation.

I want to say this isn't just my opinion.
I recently attended a conference at the Army War College where many of the attendees took this position.

I would like to say something else, too. This is really disturbing to me. In my everyday life I run across people who are storing large quantities of food and water to protect against the power grid failing.

I understand that there is actually a technical solution for this. As a matter of fact, I have talked to one of the world's foremost experts, who is here in the room today, who says that this can be protected against at moderate cost.

My question, and I am just going to put it to the commissioners and it is very simple. I understand a lot of things about how complicated the legal process is and how complicated the regulation in this industry is. I appreciate that many people have good intentions that are trying very hard, but I think we are running out of time here.

My question very simply put is: If NERC does not fix this problem of high-impact/low-frequency events, especially solar flares, within the next three years, will the commissioners vote to decertify NERC? That is my question.
COMMISSIONER LA FLEUR: Well, thank you for the question and for bringing up the importance of the issue. I guess as the question presages the first thing is to ask what NERC is doing on this, which I know is something that is on all of our minds. Maybe we will start there.

MR. CAULEY: Thank you, Commissioner.

First of all, I appreciate that there is a concerned customer in the room. I was thinking earlier it would be interesting to have had customer perspectives on the panel.

The issue raised and a few others are the things that we take very seriously. The industry has a tremendous record of dealing with major crises in terms of hurricanes, earthquakes, and storms and being able to restore the system quickly. There are some things that we have not faced. The question is: Are we ready for them? And, what are we doing to get ready?

The high-impact, low-frequency report I don't know if the Commission also did one, but I know we did one where we had a workshop and we gathered the industry experts in North America and produced a report.

From that report, the NERC Board just
recently approved an action plan that really focuses on three. One is a concurrent attack on multiple facilities and substations, a physical attack; a concurrent cyber attack; and the third priority is the GMD or the solar flare issue that was raised. We have assigned groups to work on that.

I agree with the gentleman that some of the solutions may be low-hanging fruit that we can implement and some will be much more difficult, much more expensive. We are going after those.

Those are my worries as well for the catastrophic failure type events where there are prolonged outages, more than the customary hours and days following a storm, but something that could seriously disable the system for a longer period of time, we must be ready for those. I know I have got the commitment of the industry CEOs to resolve those particular three problems.

COMMISSIONER LA FLEUR: Is that anyone else who would like to add anything?

(No verbal response.)

COMMISSIONER LA FLEUR: I mean, I guess I would just say that when the next certification of NERC comes, we will look at NERC's performance overall, just as we did this time, but it sounds
like we can expect action considerably sooner than
three years from everything that is going on.

MR. JAMES: Thank you. Good afternoon,
commissioners. My name is Dan James. I am vice
president of public affairs and marketing at P&GC
Power located in Portland, Oregon.

I am here today representing 12 small,
rural electric distribution cooperatives located in
the Pacific Northwest that are required to be
registered with WECC and NERC.

We worked very closely with our colleagues
at WECC and NERC, but we are advised by counsel that
WECC is applying Reliability Standards the
facilities used in local distribution in a manner
that violates specific limitations expressed in
Section 215 of the Federal Power Act.

As you know, this section states that
Reliability Standards are to apply only to the
Bulk-Power System and expressly are not to apply to
facilities used in local distribution.

For example, WECC is interpreting
Reliability Standard PRC 5 to require registered
facilities in their maintenance and testing
programs, not just Bulk-Power System facilities.
This is not allowed under Section 215 of the Act.
We have already had initial conversations with WECC and we are planning to sit down with WECC and NERC to discuss this issue face to face in more detail.

We are hopeful that such discussions will result in specific guidance to ensure the Reliability Standards stop being interpreted to apply to facilities used in local distribution as Congress intended.

Here is my question. How does the Commission intend to ensure that Regional Entities do not extend their reach over facilities not covered by Section 215?

Thank you for this opportunity to ask this question.

MR. CAULEY: I can help with that one.

COMMISSIONER LA FLEUR: Well, I was going to say that earlier this morning, it seems like a week ago now, but I believe it was this morning we were in this room and actually issued an order on that very topic, not this specific topic of those LPCs, but the topic of the definition of the Bulk-Electric System. NERC will be looking at that. It is a bit unfair to ask Mr. Cauley to comment on the order that just was put out a couple of hours
ago.

MR. CAULEY: I won't try to, Commissioner. To answer the gentleman's question, some of the standards do apply to users of the Bulk-Power System. The legislation was carefully crafted to be owners, operators, and users of the Bulk System. There are some standards that do apply to distribution operators and load-serving entities.

I agree with the gentleman that we should not be directing maintenance of distribution facilities. There are exceptions where, for example, the interfrequency load shedding relays that are in the distribution system are actually used for a Bulk-Power purpose.

Not knowing any more about the facts and circumstances, I would welcome a letter or an email or something in terms the specific circumstances because we would not have a standard on maintenance of distribution.

I do agree conceptually the order, which I haven't read yet, would give us the ability to look at the issues in terms of what really is necessary for Bulk-Power reliability. Whether that be a relay that is in the distribution system under frequency load-shedding purposes or whatever that purpose is.
I look forward to reading that order. I also look forward to any written submittal, if you have something in particular.

COMMISSIONER LA FLEUR: Thank you, Mr. Cauley.

Other questions from the audience? Yes?

MR. MANTA: Hello. My name is Chuck Manta. I am coming as an individual. Although, for background purposes, I am strategic advisor to a national association of local governments called Public Technology Institute, an InfraGard member.

In my consulting duties, I help emergency management planners and IT officials with their business continuity plans and their cybersecurity plans.

The question I have that came to mind as I was at the hearing today listening to everyone was trends that I see that may increase your workload orders of magnitude, and I would like to relay what that question is in my question this way by posing an example.

If you are a federal CIO, for example, and you outsource half of your work to, say, Northrop Grumman, you are not only responsible by
law to prove that you are securing government
information assets, you are also required to prove
that any of your subcontractors follow those same
guidelines, including those that might provide any
of the environment necessary for that information to
be secure.

Now, with the convergence of power and
telecommunications, that means a company like that
also has to prove that their telecommunications
providers are meeting those same requirements they
are legally upheld to provide.

With convergence with power, for example,
with Smart Grid, and also global threats such as
hackers, or the Hundred Year Solar Storm, suddenly I
could imagine all of those folks in the public
sector initially and eventually in the private
sector wanting to go to their utility and ask a very
simple question.

"Prove to me that you are reliable or show
me your contingency plan as to what you are going to
do, if you are not because by law I have to create a
contingency plan that takes all of that into
consideration."

I am wondering in light of that, is there
with these emerging trends and the growth of these
cyber threats that are as pervasive as they are, is that going to require all of us to figure out a way to work more closely together in a facilitative way where the end-user customers are working through their entire supply chain or reliability of power this way? That is a question for either an answer from a process point of view.

Thank you.

MR. NAUMANN: I would just say in general utilities work very closely with their end-use customers. The type of contact obviously depends on the type of customer and their specific needs. We have done that for a long time.

I know a number of fellow EI companies that serve sensitive federal facilities have very specific contacts with those facilities and continue to. I would expect that would continue going forward looking at their needs for reliable supply and for restoration, if something bad happens.

COMMISSIONER LA FLEUR: Thank you, Mr. Naumann.

Obviously the topics the gentleman spoke about, the convergence of telecom and the importance of the security of the grid, are pretty central to a lot of what we will be working on.
COMMISSIONER SPITZER: Commissioner, the
gentleman may not have been aware that Sunday
morning the five of us were in Atlanta at a
technical conference noticed to the public jointly
with the National Association of Utility
Commissioners, covering a panel with very detailed
discussions of precisely that issue, the convergence
of telecomm, utilities, cyber threats, and the like.

There were more questions raised than
answers I would think, but it is on our radar screen
I would say.

MR. McMAHON: My name is Kevin McMahon,
and I represent Calpine Corporation. I am the chief
compliance officer for the company.

I heard a lot of discussion today around
the NRC and the programs they have in place for
auditing. In my prior roles at other companies, I
have worked in those program.

I would also suggest working through the
concept of the OIG work plan, which basically gives
a framework for entities to go about reviewing their
own self-audit process and ensuring that they are
going after the most critical matters as designated
by both FERC and NERC.

One of the major labor issues for us is
understanding the audit process. As the chief
auditor for the company as well, I would like to as:
What is the effort being made by either FERC or NERC
around standardization of the audit process to
mirror some outside agency such as the IIA or the
AICPA, one of those bodies where the governance
around evidence and audit process is standardized
rather than recreating the wheel each time we have
an audit?

That is my question. Are we moving or
suggesting moving toward a standardized audit
process and audit evidence that is published either
through generally accepted principles of some other
agency?

MR. CAULEY: Well, we have -- Gerry Cauley
with NERC -- a preliminary cut at that I think in
the startup of our program. We did have operator --
I mean, auditor training in terms of the conduct of
the audit, ethics, and generally the technical
issues around the audit.

From a getting to first base perspective,
I think we accomplished what we needed to, to get
started. I think that Dan Skaar, who is a fellow
audit expert, is sort of our conscience in terms of
where we need to go and in terms of upping our game
in the audit arena.

We are looking at both how do we incorporate the risk model into our audits. But the degree of rigor around some of the suggestions that the gentleman had, we also realize that our training at this point for auditors is fairly rudimentary, to parse a word, but it is simple and straightforward.

But we need to elevate something of a qualification, a certification, for our auditors that at a beginning level and maybe a more senior level. We will be looking to put that program together.

If I get my wish, we would actually make some of that material and training available more broadly to compliance folks in the registered entity, so they could also benefit from sort of pre-preparing themselves in terms of how to conduct audits. We would have a NERC credential on auditors. That is in our plans. We have got goals emerging on developing that.

COMMISSIONER LA FLEUR: Thank you, Mr. Cauley.

Norman Bay?

MR. BAY: Yes. The Division of Audits tries to work very closely with NERC and with the
Regional Entities. We have gone on a number of observation audits where we go with the RE's audit team, observe what they do, and provide them with some feedback in an attempt to provide the kind of consistency that I believe the gentleman was asking about.

MR. CAULEY: We agree with that.

COMMISSIONER LA FLEUR: Thank you.

COMMISSIONER SPITZER: Commissioner?

(No verbal response.)

COMMISSIONER SPITZER: I understand the frustration of the questioner but the fact is, Gerry alluded to it, if we are looking at the AICPA analogy, the statute, our statute has been operative for five years. We have had GAAP for hundreds of years. Rome wasn't built in a day I would think.

COMMISSIONER LA FLEUR: Well, seeing no further questions from the audience, I will do what I prematurely did a few minutes ago and turn to Chairman Wellinghoff.

CHAIRMAN WELLINGHOFF: I will start again by rethanking this panel and the previous panel, and just making two points. In quick conclusion, I certainly am very encouraged by the willingness of us all to work together, and I want to continue to
do that.

A second point is the two areas that I think we have touched upon in these panels that I would like to move quickly with would be of course the traffic ticket type process for the minor violations, and the second would be anything again that we could do to assist in the National Transmission Forum work. Thank you all. I appreciate it.

COMMISSIONER LA FLEUR: Thank you, Mr. Chairman.

Mr. Moeller, anything?

COMMISSIONER MOELLER: (Moving head from side to side.)

COMMISSIONER LA FLEUR: (No microphone.) Sorry. I thought I just turned it on, and I turned it off.

Well, I will start again and thank both panels that we have heard from this afternoon for your thoughtful participation and the candor and quality of your comments.

I think you gave us all a lot to work on, but it was very encouraging that there were some real themes that are much easier to work on and really approach together.
Today is really a series of technical conferences, starting with the one that I was not at when I was a lady-in-waiting in July. I guess we are going to have one with the topics to be determined with NERC and others early in the new year and really look forward to continuing the discourse.

Thank you everyone who attended the session also. Thank you. Thank you to the staff from OE and OER, especially Roger Morie, who put it together.

(WHEREUPON, at 4:49 p.m., the technical conference was concluded.)

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