

132 FERC ¶ 61,149  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Marc Spitzer, Philip D. Moeller,  
John R. Norris, and Cheryl A. LaFleur.

Western Electricity Coordinating Council

Docket No. PA09-5-000

ORDER APPROVING AUDIT REPORT, DETERMINING ISSUE OF  
SEPARATION OF FUNCTIONS, AND DIRECTING  
COMPLIANCE AND OTHER CORRECTIVE ACTIONS

(Issued August 20, 2010)

1. In this order, the Commission approves the attached Audit Report (Report) prepared by the Division of Audits in the Office of Enforcement (OE), with the assistance of staff from the Office of Electric Reliability (OER). The Report contains staff's findings and recommendations with respect to the Western Electric Coordinating Council (WECC) Regional Entity (RE) function. The audit evaluated WECC's compliance with: (1) the Regional Delegation Agreement between the North American Electric Reliability Corporation (NERC) and WECC; (2) the WECC bylaws; and (3) other obligations and responsibilities as approved by the Commission.
2. This audit was intended to help the Commission determine whether WECC has demonstrated a strong separation between its Compliance Monitoring and Enforcement program (CMEP) and the reliability functions for which it is registered, as well as sufficient independence from users, owners, and operators within the Western Interconnection, consistent with the requirements of Order No. 672.<sup>1</sup> WECC is responsible for providing services to the members, including responsibility for the reliability coordinator (RC) and interchange authority (IA) functions that must comply with the applicable Reliability Standards approved by the Commission.

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<sup>1</sup> *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204, *order on reh'g*, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006).

3. Staff informed WECC of the audit findings and recommendations in a draft audit report on February 2, 2010. The draft report was revised on March 10, 2010 and April 8, 2010 to incorporate comments made by WECC. The Report found that WECC has improved the separation between WECC and the CMEP oversight of the RC and IA functions. As the Report indicated, the primary step WECC had taken was to finalize a contractual arrangement with NERC to provide CMEP oversight of WECC's registered reliability functions. However, the Report identified some additional areas of concern that WECC must address to create the independence of oversight and operational functions, as contemplated by Order No. 672.<sup>2</sup> These areas included: WECC's accounting practices; its failure to obtain Commission authorization for its performance as the IA as a statutory function, i.e. a function required to be funded through NERC, as the Commission-approved Electric Power Organization, pursuant to section 215 of the Federal Power Act (FPA)<sup>3</sup>; its lack of creating proper safeguards for ensuring independence and data confidentiality when establishing a Board-level Compliance Committee; its efforts at reducing backlogs in its CMEP; and its protocols for dealing with inappropriate communications involving CMEP staff.

4. Although it did not agree with certain aspects of the principal findings and conclusions in the Report, WECC has agreed to, or has already begun to, undertake the recommended corrective actions in the April 8, 2010 draft of the Report.

5. Based on the results of the audit and WECC's agreement to implement the Report's recommendations, as explained below, we conclude that upon implementation of the recommendations, WECC prospectively will satisfy the requirement that it "demonstrate a strong separation between oversight and operational functions."<sup>4</sup> We condition this conclusion on WECC's timely and effective implementation of the Report's recommendations, including the filing of an implementation plan as specified below.

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<sup>2</sup> *Id.* at P 656-57 (finding that a Regional Entity may perform reliability-related functions provided that they "do not conflict or interfere with the performance of a delegated function" and do not "compromise the oversight role or independence of the Regional Entity.").

<sup>3</sup> 16 U.S.C. § 824o (2006).

<sup>4</sup> *North American Electric Reliability Council, et al.*, 119 FERC ¶ 61,060, at P 551 (2007) (Delegation Agreements Order), *order on reh'g*, 120 FERC ¶ 61,260, *order on compliance filing*, 122 FERC ¶ 61,245 (2008), *order on compliance filings*, 125 FERC ¶ 61,330 (2008).

## **Background**

6. In Order No. 672, the Commission discussed the generic issue of whether a Regional Entity may perform functions beyond the proposal and enforcement of Reliability Standards. The Commission found that a “Regional Entity may conduct such activities, provided that they do not conflict or interfere with the performance of a delegated function, which we view as the primary mission of a Regional Entity.”<sup>5</sup> The Commission further found that “any additional activity must not compromise the oversight role or the independence of the Regional Entity.”<sup>6</sup>

7. In the Delegation Agreements Order, the Commission, *inter alia*, approved WECC’s Regional Delegation Agreement (RDA) and CMEP. In that order, the Commission stated that “WECC, as a Reliability Coordinator, is a user, owner or operator of the bulk-power system. As such, WECC is obligated to demonstrate a strong separation between oversight and operational functions.”<sup>7</sup>

## **The Audit**

8. On November 13, 2008, OE staff issued a public letter to WECC in this docket announcing the commencement of an audit to determine whether WECC was in compliance with: (1) the Delegation Agreement between NERC and WECC; (2) the WECC bylaws; and (3) other obligations and responsibilities as approved by the Commission.<sup>8</sup> In particular, in the ensuing audit, OE staff examined the relationship between WECC RE and WECC Member Services division, which consists of users,

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<sup>5</sup> Order No. 672 at P 656.

<sup>6</sup> *Id.*

<sup>7</sup> Delegation Agreements Order at P 453.

<sup>8</sup> The November 13, 2008 audit commencement letter inadvertently stated that the audit was being conducted pursuant to section 301 of the FPA. 16 U.S.C. § 825 (2006). Commission staff conducted this audit pursuant to section 215 of the FPA. *See* 16 U.S.C. § 824o(b)(1); *see also* Order No. 672 at P 773 (stating that while the “Final Rule eliminates the proposed periodic Commission audit of each Regional Entity,” the Commission “retains authority . . . to conduct its own compliance audit in response to particular circumstances that may warrant Commission participation or intervention”).

owners, and operators of the Western Interconnection. NERC has delegated to WECC the following major program functions:<sup>9</sup>

1. Develop regional and national Reliability Standards;
2. Administer the compliance enforcement program and organization registration and certification;
3. Conduct reliability readiness evaluations;
4. Provide training, education and operator certification;
5. Conduct reliability assessment and performance analysis;
6. Conduct situational awareness and infrastructure security; and
7. Provide administrative services.

9. In addition to those functions delegated by NERC, WECC sought and was granted statutory funding for an expanded list of functions, such as: (1) Compliance Enforcement, which includes activities under the WECC Reliability Management System; (2) Training and Education; (3) Reliability Assessment and Performance Analysis, which includes WECC's Transmission Expansion Planning Program, and data gathering activities; and (4) Situational Awareness and Infrastructure Security, which includes WECC's Reliability Coordinator functions. The list of designated statutory activities is contained in Exhibit E to the RDA between NERC and WECC.

10. In the course of the audit, OE staff issued data requests, conducted analytical work, performed site visits, examined emails, and held many meetings and interviews with WECC officials and staff. Subsequently, on February 2, 2010, OE staff sent WECC a draft audit report and, at the request of WECC, staff granted WECC an extension of time until March 12, 2010, in which to respond to the audit findings and recommendations. On February 16, 2010, OE and OER staff conducted an extended phone conference with WECC to assist them in their review of the draft report. After a meeting with WECC on February 24, 2010, OE staff conducted an additional follow-up teleconference on March 1, 2010, to discuss the draft audit report. Then on March 5, 2010, OE staff sent WECC a revised draft audit report with a March 25, 2010 deadline for WECC's response. Based on further discussion, OE staff sent a revised draft report to WECC on April 8, 2010. WECC's response to the draft audit report is attached to this order.

### **The Audit Report**

11. As discussed more fully below, the Report reveals five areas of concerns involving: (1) WECC's accounting practices and procedures and its inability to

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<sup>9</sup> *North American Electric Reliability Corporation*, 117 FERC ¶ 61,091, at P 20 (2006), *order on reh'g*, 119 FERC ¶ 61,059 (2007).

segregate statutory and non-statutory monies and track statutory and non-statutory costs; (2) the WECC's registration as the IA for the Western Interconnection without prior Commission review and approval; (3) the need to ensure the independence of the Regional Entity's performance of CMEP functions and the protection of confidential information with respect to the oversight of the WECC Compliance Committee (WCC); (4) potential problems that WECC has yet to address regarding reducing its current caseload of compliance matters and verifications of the completion of mitigation plans; and (5) the lack of a procedure to address inappropriate communication that may occur between WECC staff and the registered entities.

12. The first concern involves the adequacy of WECC's accounting system to (1) properly segregate monies received for statutory and non-statutory functions, and (2) track costs related to non-statutory functions to prevent cross-subsidies from occurring. For example, the Report found that WECC did not segregate monies associated with the Interchange Authority (IA) function and that WECC used statutory monies to pay for employee time and expenses of carrying out this function.<sup>10</sup> The cost incurred by shared employees (i.e., employees who perform statutory and non-statutory tasks) who worked on Western Renewable Generation Information System, a non-statutory activity, was not accurately tracked to prevent cross-subsidization.<sup>11</sup> These concerns with the accounting system raise additional concerns of how WECC will segregate and account for grant monies it is expected to receive for activities not funded with section 215 monies. In this regard, the Report cites several concerns with the accounting system functionality to accurately account for the expected grant funds.<sup>12</sup>

13. The second concern is about WECC being registered as the Interchange Authority for the Western Interconnection. The ERO Certification Order requires that the roles, responsibilities, functions and everything else that an RE does be incorporated in the RDA and identified as either statutory or non-statutory.<sup>13</sup> This is to allow sufficient detail for the Commission or stakeholders to determine the

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<sup>10</sup> *Id.* at 19.

<sup>11</sup> *Id.* at 19-20.

<sup>12</sup> *Id.* at 17-19.

<sup>13</sup> *North American Electric Reliability Corporation*, 116 FERC ¶ 61,062, at P 173, 184 and 580 (2006), *order on reh'g and compliance*, 117 FERC ¶ 61,126 (2006).

complete scope of statutory activities.<sup>14</sup> The Report found that Exhibit E of WECC's RDA did not include the IA function. Further, although WECC has been performing the IA function as a statutory duty, it has not sought Commission approval for the performance of this reliability function within its statutory duties.<sup>15</sup>

14. The third concern is the safeguards that need to be in place to prevent the WECC Compliance Committee (WCC) from exercising undue influence over the independence of the Regional Entity's performance of its CMEP activities, and that confidential CMEP information may be inappropriately disclosed. The Report describes evidence collected during the audit about the motivation on the part of some parties in seeking the creation of the WCC. This evidence suggests that certain WECC members had concerns about the CMEP being too independent of members and also that the members had a need to have greater access to confidential information from the CMEP and NERC.<sup>16</sup>

15. The fourth area of concern relates to WECC's attempts in 2008 to reduce a backlog in its CMEP program by accepting mitigation plans for self-reported violations without verifying the successful completion of the mitigation plans. WECC proposed that its verification would be conducted when the entity was next subject to audit and that if any problems in the mitigation plan were disclosed at that time, any penalties would be assessed commencing with the completion of the audit process, rather than at the time of the initial report of violation. Although WECC terminated its backlog reduction plan upon receiving an unfavorable opinion from NERC, the Report cites several issues that WECC must address.<sup>17</sup> For instance, WECC does not have a policy or procedure to address a potential situation in which a mitigation plan was accepted pursuant to the backlog reduction plan, but later found to be incomplete (i.e., the mitigation did not occur despite a registered entity officer's attestation that it did.)<sup>18</sup>

16. The last area of concern is that WECC does not have a procedure to address inappropriate communication between WECC staff involved in the CMEP process

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<sup>14</sup> *Id.*

<sup>15</sup> Report at 22-25.

<sup>16</sup> *Id.* at 26-34.

<sup>17</sup> *Id.* at 35-38.

<sup>18</sup> *Id.* at 38.

and the registered entities.<sup>19</sup> The Report identifies concerns about WECC staff not having adequate training or procedures to protect the CMEP process from undue influence. WECC has been reorganizing its CMEP program staff during the course of this audit and certain key positions are filled with individuals who are inexperienced in their roles and responsibilities. This concern is exacerbated by the hybrid nature of the WECC governance, which includes market participants in oversight roles for the CMEP. For these reasons, there is a risk that WECC employees may not know how to respond if inappropriately contacted by a member, user, owner, or operator in WECC's region, and in particular, by a market-participant Board member during a compliance audit of that person's registered entity.<sup>20</sup>

### **WECC Response**

17. In its response, WECC maintains that it adequately segregated monies for statutory and non-statutory functions.<sup>21</sup> Further, WECC disagrees with the Report's concerns that WECC may not have properly identified and funded activities that it performs on behalf of its members, such as the IA function.<sup>22</sup> Regarding the IA function, WECC contends that the Report "appears to assume that previously funded activities no longer qualify if compliance registration is required."<sup>23</sup> WECC also asserts that the Report's concern regarding the treatment of grant monies is premature.<sup>24</sup>

18. WECC disagrees with the Report's findings regarding the WCC and states that the Report's concerns "appear to suggest an antagonism toward a hybrid Board of Directors."<sup>25</sup> Further, in the event of a conflict of interest, WECC maintains that its Standards of Conduct specifically require recusal by a Board member.<sup>26</sup>

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<sup>19</sup> *Id.* at 39-41.

<sup>20</sup> *Id.* at 40.

<sup>21</sup> WECC Response at 4.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 6.

<sup>24</sup> *Id.* at 5.

<sup>25</sup> *Id.* at 9, 11.

<sup>26</sup> *Id.* at 10.

Notwithstanding its disagreement with the findings, WECC states that it “accepts the recommendations as a way to strengthen WECC’s internal controls.”<sup>27</sup> WECC asserts that if audit staff’s approval is required for the WCC to continue, WECC does not agree with the recommendation. Similarly, WECC maintains that “internal governance issues such as [that in Recommendation No. 10] do not require Commission approval as they relate to performance and management of corporate personnel.”<sup>28</sup>

### **Discussion**

19. The Commission accepts the audit findings. With regard to the concerns raised in the Report concerning the WCC, WECC has agreed to implement the Report’s recommendations, provided that the WCC recommendations do not interfere with WECC’s internal governance as it relates to performance and management of corporate personnel. This audit was conducted pursuant to Section 215 of the FPA and was intended, among other things, to examine WECC’s ability to independently perform its responsibilities as a Regional Entity. Accordingly, the Report cites concerns about the WCC’s ability to impede the RE’s independent operation of the CMEP and the protection of confidential information, and sets forth several recommended actions to address those concerns. We require WECC to comply with the recommended actions in the Report.

20. Regarding WECC’s accounting for the IA function, WECC states in its response that it “will segregate costs for performing the [IA] function from other section 215 functions until FERC has an opportunity to review and approve the function as statutory.”<sup>29</sup> In the past, WECC in fact accounted for the IA function as a statutory function without the Commission having the opportunity to determine whether WECC’s performance of this function should receive such treatment.<sup>30</sup>

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<sup>27</sup> *Id.* at 9 - 10.

<sup>28</sup> WECC Response at 15.

<sup>29</sup> WECC Response at 4.

<sup>30</sup> The question of whether the WECC IA function itself may be treated as a statutory activity for funding purposes is not currently before this Commission. However, its April 22, 2010 filing in Docket No. RR10-9-000 for its amended 2010 business plan and budget, WECC requested that the WECC Interchange Tool, which WECC uses to perform the IA function, be considered as a statutory activity under the Situation Awareness and Infrastructure Security Program. We will address that issue in that proceeding.

Without such Commission approval, we find that the Report correctly recommends that WECC segregate the costs associated with performing the IA function from section 215 funding. Therefore, we accept the Report's recommendation regarding WECC's accounting of the IA function.

21. We also are not persuaded by WECC's argument that the Report's concerns regarding the treatment of yet to be received grant monies is premature. The Report found that WECC did not have policies and procedures to ensure proper classification of and accounting for future grant costs and funding. As we have previously held: "Statutory and non-statutory activities must be properly accounted for and segregated to ensure that funds are appropriately collected under section 215 to the Federal Power Act."<sup>31</sup> WECC must ensure that section 215 funding does not include current or future non-statutory activities. Thus, we direct WECC to comply with the accounting recommendations in the Report.

22. As noted above, while WECC did not agree with certain aspects of the principal findings and conclusions in the Report, it has agreed to (and in some cases has already begun to) implement the recommended actions in the Report. Based on the results of the audit and WECC's agreement to implement the Report's recommendations, we conclude that upon implementation of the recommendations, WECC will prospectively satisfy the requirement that it demonstrate a "strong separation between oversight and operational functions," as Order No. 672 specifies for Regional Entities that perform functions beyond the proposal and enforcement of Reliability Standards. This conclusion is conditioned on WECC's timely and effective implementation of the Report's recommendations, including the submission of an implementation plan as specified below.

23. The Report requires WECC to design an implementation plan that includes procedures to implement the recommendations that are described in the audit report. The plan is to be submitted to OE staff for review and approval within 60 days from the date of issuance of this order. Thereafter, WECC must make non-public quarterly submissions in Docket No. PA09-5-000 to OE staff detailing WECC's progress in implementing the actions set forth in the Report until all the actions are completed. The submissions are to be made not later than 30 days after the end of each calendar quarter, beginning with the first quarter after the submission of the implementation plan and continuing until WECC completes all the recommended actions. We direct OE staff to conduct a post-audit site visit when WECC states that it has completed all of the recommendations to ensure that all of the corrective actions taken as a result of

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<sup>31</sup> *North American Electric Reliability Corporation*, 126 FERC ¶ 61,123, at P 9 (2009).

implementing the recommendations were properly completed. We also direct OE staff to conduct another audit of WECC in FY 2012.

The Commission orders:

- (A) The attached Report is approved as explained in the body of this order.
- (B) WECC is directed to implement the actions recommended in the Report as clarified in the body of this order.
- (C) WECC is directed to submit an implementation plan outlining the steps it will take to implement the recommendations in the Report within 60 days from the date of issuance of the final report in this docket.
- (D) WECC must make non-public quarterly submissions in Docket No. PA09-5-000 detailing its progress in implementing the corrective actions until all the corrective actions are completed. The submissions must be made not later than 30 days after the end of each calendar quarter, beginning with the first quarter after the submission of the implementation plan and continuing until WECC completes all the recommended corrective actions.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.

## Attachment A



Federal Energy Regulatory Commission

**Audit of Regional Entity  
Independence of the  
Western Electricity  
Coordinating Council**

Docket No. PA09-5-000

Date: April 22, 2010

**Office of Enforcement  
Division of Audits**

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## I. Executive Summary

### A. Overview

The purpose of this audit is to address the ability of the Western Electricity Coordinating Council (WECC) to independently perform its responsibilities as a Regional Entity (RE) and the RE's independence from all reliability functions for which WECC has registered itself. WECC is registered as the Reliability Coordinator (RC)<sup>1</sup> and as the sole Interchange Authority (IA) for the Western Interconnection. The overall objective of the audit is to determine whether WECC was operating in compliance with (1) the Regional Delegation Agreement (RDA) between the North American Electric Reliability Corporation (NERC) and WECC,<sup>2</sup> (2) the WECC Bylaws,<sup>3</sup> and (3) other obligations and responsibilities as approved by the Commission. The audit covered the period from May 18, 2007 to the present.

### B. Western Electricity Coordinating Council

Under section 215(e)(4) of the Federal Power Act (FPA),<sup>4</sup> the Commission may approve NERC's delegation of authority to REs to propose and to enforce reliability standards. As an RE, WECC oversees 469 registered entities, including

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<sup>1</sup> WECC had initially funded through section 215 of the Federal Power Act (FPA) three RC centers: the California Mexico Reliability Coordinator, Rocky Mountain Desert Southwest Reliability Coordinator, and Pacific Northwest Security Center. Beginning January 2009, WECC consolidated its RC functions to centers in Loveland, CO, and Vancouver, WA.

<sup>2</sup> *North American Electric Reliability Council, et al.*, 119 FERC ¶ 61,060 (2007) (Delegation Agreements Order), *order on reh'g*, 120 FERC ¶ 61,260, *order on compliance filing*, 122 FERC ¶ 61,245 (2008) (Second Delegation Agreements Order), *order on compliance filings*, 125 FERC ¶ 61,330 (2008) (Third Delegation Agreements Order).

<sup>3</sup> *Id.*

<sup>4</sup> 16 U.S.C. § 824o(a) (2006).

1,252 registered functions in the Western Interconnection.<sup>5</sup> Within WECC's footprint, NERC has delegated to WECC the following major program elements:<sup>6</sup>

1. Develop regional and national reliability standards;
2. Administer the Compliance Monitoring and Enforcement Program (CMEP) and organization registration and certification;
3. Conduct reliability readiness evaluations;
4. Provide training, education, and operator certification;
5. Conduct reliability assessment and performance analysis;
6. Conduct situational awareness and infrastructure security; and
7. Provide administrative services.

However, in its application to the Commission for approval of the RDA, WECC sought and was granted funding through the NERC and WECC budget pursuant to FPA section 215 (statutory funding) for an expanded list of functions. The complete list of designated statutory activities was contained in Exhibit E to the RDA dated October 16, 2007. The scope of the additional activities funded includes:

- Compliance Enforcement - This category was expanded to include activities under the WECC Reliability Management System;
- Training and Education - This category includes WECC's Training Program;
- Reliability Assessment and Performance Analysis - This category includes WECC's Transmission Expansion Planning Program, and Loads and Resources Area, including necessary data gathering activities; and
- Situational Awareness and Infrastructure Security - This category includes WECC's Reliability Coordinator Functions.

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<sup>5</sup> As of November 30, 2009.

<sup>6</sup> *North American Electric Reliability Corporation*, 117 FERC ¶ 61,091, at P 20 (2006) (Business Plan and Budget Order), *order on reh'g*, 119 FERC ¶ 61,059 (2007).

As will be discussed in more detail later in the audit report, WECC has interpreted this expansion of the scope of funded activities as encompassing all of its activities, except for a special program, the Western Renewable Energy Generation Information System (WREGIS), which tracks renewable resources within the region.

The WECC region encompasses a vast area of nearly 1.8 million square miles. It is the largest and most diverse of NERC's eight regional entity areas. WECC's footprint extends from Canada to Mexico. It includes the Canadian provinces of Alberta and British Columbia, the northern portion of Baja California, Mexico, and all or portions of fourteen western states in the United States. Transmission lines span long distances, connecting the Pacific Northwest, with its abundant hydro-electric resources, to the Southwest, with its large coal-fired and nuclear power plants.

WECC is the RE for the entire Western Interconnection. In addition to its duties as the RE, WECC has registered, on behalf of its members, as the RC and, subsequent to the execution of the RDA, as the sole IA.<sup>7</sup> This structure creates a conflict of interest in that the entity that administers compliance with the NERC reliability standards (i.e., WECC) is the same entity whose compliance to the standards must be monitored and enforced (i.e., WECC). This conflict of interest was of concern to the Commission and was a major impetus for the commencement of this audit.<sup>8</sup> In order to deal with this lack of separation, WECC entered into contract negotiations with NERC for NERC to perform all compliance reviews of the reliability standards for which WECC is the registered entity. This was done in response to the Second Delegation Agreements Order, which conditionally approved the RDA.<sup>9</sup> On February 17, 2009, after the commencement of the audit, the Director of the Office of Electric Reliability approved the NERC-WECC CMEP Agreement by an unpublished delegated letter order in Docket No. RR06-1-018 *et al.*

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<sup>7</sup> The Commission has not yet approved this latter registration as being a statutory function under section 215, as discussed later.

<sup>8</sup> *North American Electric Reliability Council, et al.*, 122 FERC ¶ 61,245 (2008).

<sup>9</sup> *Id.* at P 226.

### C. Commission Orders on Regional Entity Independence

Pursuant to FPA section 215,<sup>10</sup> the Commission issued an order in July 2006 certifying NERC as the Electric Reliability Organization (ERO).<sup>11</sup> Pursuant to FPA section 215(e)(4), the ERO is authorized to delegate authority to an RE for the purpose of proposing reliability standards to the ERO and enforcing mandatory, Commission-approved reliability standards. NERC's *pro forma* Delegation Agreement, including the CMEP to be used by NERC and the RE to monitor, assess, and enforce compliance within the United States with NERC's Commission-approved reliability standards, was approved by the Commission in April 2007 in the Delegation Agreements Order.

The Commission approved the *pro forma* Delegation Agreement in accordance with FPA section 215, which authorizes the Commission to approve delegation of the ERO's responsibilities if: (i) the RE is governed by an independent Board, a balanced stakeholder Board, or a combination of the two; (ii) the RE otherwise satisfies the criteria required for certification of the ERO; and (iii) the proposed agreement promotes effective and efficient management of the Bulk-Power System. As relevant here, the Commission observed:

*Composition and Election of the Board (Criterion 1):* WECC represents that it will be governed by a combination independent and balanced stakeholder Board. WECC asserts that its Board will be balanced because, as explained below, it will have an equal number of representatives from each of WECC's six member classes as well as nonaffiliated directors and a Mexican director. WECC refers to the following provisions of the WECC bylaws:

*Section 6.2:* Section 6.2 provides that the Board is made up of thirty-two directors. Twenty-four directors are elected by WECC's six member classes, i.e., sectors, with each sector entitled to elect four directors. Seven non-affiliated directors

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<sup>10</sup> 16 U.S.C. § 824o (2006).

<sup>11</sup> *North American Electric Reliability Corp.*, 116 FERC ¶ 61,062, *order on reh'g and compliance*, 117 FERC ¶ 61,126 (2006), *order on compliance*, 118 FERC ¶ 61,030, *order on compliance*, 118 FERC ¶ 61,190, *order on reh'g*, 119 FERC ¶ 61,046 (2007).

are elected by WECC's members as a whole. One director may be elected from WECC's Mexican delegation. At Board meetings, a quorum requires the presence of seventeen directors, including three non-affiliated directors and one director from each of any four member classes. Board business calls for an affirmative majority of director votes when a quorum is present.<sup>12</sup>

The Commission concluded:

We find that the WECC bylaws and the representations made in Exhibit B of the WECC Delegation Agreement satisfy the governance requirements of FPA section 215 and the *pro forma* Exhibit B governance criteria. We also identify modifications to be addressed by NERC and WECC. The WECC Board will be independent because it will be comprised of directors chosen from all industry segments, with no two sectors able to control a vote. No single sector will be able to veto a measure, given WECC's quorum and voting protocols. As such, WECC's Board composition and voting protocols are designed to ensure that WECC will be independent of industry sectors and be governed by an appropriate balance of unaffiliated directors and stakeholder interests.<sup>13</sup>

#### **D. Organizational Structure**

As noted above, WECC is governed by a Board comprised of 32 directors, 24 of which are Member Class Directors selected by members of their respective class, along with seven non-affiliated directors elected by the members as a whole and one director from Mexico. The Board conducts its regularly scheduled meetings on a quarterly basis.

To assist the Board in its administration, WECC has three standing member committees. Each standing committee deals with a particular WECC activity area and makes recommendations to the Board regarding those activities. The Planning Coordination Committee deals with issues related to generation and load balance,

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<sup>12</sup> Delegation Agreements Order at P 446.

<sup>13</sup> Delegation Agreements Order at P 452.

and the adequacy of the infrastructure of the Bulk-Power System (BPS). The Operating Committee considers the operation and security of the BPS. The Market Interface Committee considers the impact of reliability standards and practices of commercial electricity markets on the reliability of the BPS.

On April 30, 2009, the WECC Board approved the creation of the Compliance Committee, which is intended to provide more effective oversight of the CMEP. The role of this newly created committee will be discussed in greater detail later in this audit report.

WECC's complex RE structure demonstrates the expansive duties that were appended to the scope of the activities that are funded pursuant to section 215 under the RDA. These include the RC function (a large division within WECC's operations), a large planning department to deal with the expanded transmission study duties, and additional training staff to incorporate the extended operations training provided by WECC.

The complexity and diversity of activities in which WECC is engaged presents challenges in administration. When the scope of activities is coupled with a Board the size of WECC's (i.e., 32 directors), the challenges become even more difficult. When the fact that the Board only meets quarterly is considered, the administrative challenges become even more severe.

## **E. Summary of Compliance Findings**

Audit staff's concerns are summarized below. A detailed discussion of the audit concerns is included in section II of this report. Audit staff found five areas of concern:

- **WECC's Accounting Practices**

The Audit staff found a lack of specificity in the accounting practices of WECC. This lack of specificity makes it difficult to determine if appropriate costs are being funded under section 215. In addition, WECC's record keeping for employee tasks does not allow costs to be adequately identified to determine the appropriateness for funding under section 215. Finally, Audit staff is concerned with WECC's potential handling of grant money under section 215 funding.

- **WECC's Assumption of the Interchange Authority Function**

Audit staff has concerns regarding WECC's registration as the IA for the Western Interconnection without prior Commission review and approval of the registration. Performance of the IA function is not included in WECC's RDA, and WECC has not sought Commission approval for either the performance of this reliability function within its statutory duties, or statutory funding for the IA function.

- **WECC's Compliance Committee**

Audit staff has concerns about WECC's creation of the WECC Compliance Committee (WCC). Audit staff has concerns that the WCC may reduce the independence of the RE's performance of its CMEP activities and that confidential CMEP information may be inappropriately disclosed. If WECC desires to create more effective oversight for the CMEP, it needs to better ensure independence of the CMEP function and protection of the confidentiality of the CMEP data.

- **WECC's Mitigation Backlog Reduction Plan**

Audit staff believes that issues remain from the plan WECC developed and implemented to reduce its compliance mitigation backlog during the summer of 2008. Although WECC terminated the backlog reduction plan upon receiving an unfavorable opinion from NERC, WECC needs to address the potential problems that resulted from its initial implementation of the plan.

- **Procedures and Protocols for Reporting Inappropriate Communications**

WECC does not have a procedure to address inappropriate communication between WECC staff and the registered entities. WECC's hybrid Board structure presents increased risks of inappropriate communication between Board members and WECC staff during CMEP activities.

## **F. Recommendations**

To ensure WECC is correctly accounting for statutory and non-statutory activities, Audit staff recommends that WECC perform the following actions:

- Identify how WECC intends to segregate grant money received for statutorily funded tasks being performed by WECC and funded under section 215;
- Segregate the costs of performing the IA function from section 215 funds unless, and until, FERC has approved these costs for section 215 recovery;
- Provide a detailed list of all activities performed by WECC that are not specifically included as statutory or non-statutory activities in the RDA Exhibit E, including details of any expansion of previously approved functions;
- Revise its existing accounting system to properly classify and track statutory and non-statutory activities, and funding for these activities; and
- Adopt commonly accepted policies and procedures used to track actual expenditures for shared service costs, overhead costs, WECC RE staff hours, and associated costs for statutory and non-statutory functions.

As long as WECC is registered to perform the IA function, the Audit staff recommends that WECC:

- Submit a revised Exhibit E of the NERC-WECC RDA to the Commission requesting a review of whether WECC's performance of the IA function is a statutory function.

Regarding the WCC, Audit staff recommends that WECC:

- Revise the WCC charter to ensure independence of the CMEP function;
- Revise the WCC charter to ensure the confidentiality of CMEP data;
- Submit to the Audit staff for its review the Board-approved WCC charter along with details of how the WCC relates to RDA activities to ensure the independence and confidentiality of the CMEP;
- Provide a written narrative explaining how WECC intends to maintain or enhance the independence and confidentiality of the CMEP when considering any proposed changes to the WCC charter, including a process whereby WECC will inform the Commission of such impacts; and

- Develop a procedure to prevent the disclosure of confidential information.

Regarding WECC's backlog reduction plan, Audit staff recommends that WECC:

- Work with NERC and the Commission to develop and implement plans to properly quantify and address WECC's current caseload, and work towards preventing future backlogs; and
- Contact the registered entities which had completed mitigation plans which were accepted under the initial backlog reduction plan, and inconsistent with WECC's CMEP and inform these entities that the violation period will start from the date of the original self-report or June 18, 2007, whichever is later, if the entity is later found to still be out of compliance.

Regarding procedures and protocols for reporting inappropriate communications, Audit staff recommends that WECC:

- Develop and enact a procedure for WECC employees to follow if they believe they have been inappropriately contacted by any member of WECC that would apply, unless and until, WECC oversight of the CMEP process is conducted by non-affiliated parties;
- Implement a formal plan to address the performance of CMEP actions to avoid undue influence when a WECC Board member is a participant in an action, or, in the alternative;
- Enforce a mandatory recusal process for affiliated Board members who would otherwise participate in CMEP actions involving their employers; and
- Present the plans and processes to avoid actual or perceived conflict of interests to the Commission Audit staff for its review.

**G. Compliance and Implementation of Recommendations**

WECC should design a compliance plan that includes procedures to implement the exception-specific recommendations that are described in this report. The plan should be submitted to Audit staff for review within 60 days from the date of issuance of the final report in this docket. Thereafter, WECC must make non-public quarterly submissions in Docket No. PA09-5-000 to Audit staff detailing its progress in implementing the corrective actions set forth in this report until all the corrective actions are completed. The submissions should be made not later than 30 days after the end of each calendar quarter, beginning with the first quarter after the submission of the compliance plan, and continuing until WECC completes all the recommended corrective actions.

## **II. Introduction**

### **A. Objectives**

The purpose of this audit is to address WECC's responsibilities as a Regional Entity (RE) and the RE's independence from the function of the RC and the IA. The audit's overall objectives are to determine whether WECC complies with (1) the RDA between NERC and WECC, (2) the WECC bylaws, and (3) other Commission-approved obligations and responsibilities.

### **B. Scope and Methodology**

Audit staff reviewed and observed practices, procedures, and controls, as well as analyzed selected data and documents to review whether WECC complied with requirements in (1) the delegation agreement between NERC and WECC, (2) WECC bylaws, and (3) other Commission-approved obligations and responsibilities. Audit staff completed the following steps to ensure a thorough and coordinated review was conducted:

- Used publicly available information and resources to obtain a baseline understanding of WECC's organizational structure and relationship with the RC, registered entities, NERC, and other organizations that impose independent functioning concerns as they relate to the RDA, bylaws, and other obligations and responsibilities approved by the Commission. Further, Audit staff gathered and reviewed information and data that could support the independent functioning of WECC (e.g., budgets, annual reports, presentations, and reported news, etc.);
- Reviewed e-Library for filings and Commission orders involving WECC;
- Reviewed Enforcement Hotline for complaints made against WECC;
- Reviewed financial information providing budgetary and actual costs incurred by the RE (e.g., annual reports, yearly budgets, etc.);
- Reviewed relevant public and member-only access web sites to research information relevant to audit objectives (e.g., the web sites of WECC, NERC and the Commission);

- Monitored local newspapers, trade media, and academic journals to identify significant developments that arose during the audit period;
- Issued a commencement letter initiating the audit followed up by an opening conference to introduce Audit staff, meet WECC's senior management, provide an overview of the audit, and answer questions WECC may have about the audit;
- Conducted on-site visits to observe and learn about WECC business practices and procedures, and internal controls related to audit objectives. During the site visit, conducted interviews of the following:
  - Chief Executive Officer;
  - Chief Operating Officer;
  - Members of the Board of Directors including the Chairman;
  - General Counsel;
  - Vice President of Compliance;
  - Director of Operations;
  - Managing Director of Reliability Coordination;
  - Director of Standards;
  - Managing Director of Compliance;
  - Managing Director of Planning and Standards;
  - Controller;
  - Director of Market – Operations Interface; and
  - Manager of Compliance Administration.
- Collected documentation (e.g., data, written procedures, invoices, email, voice recordings) through written data requests to perform technical analyses, as well as to support findings of compliance/non-compliance with audit objectives;
- Reviewed the actions of the RE, RC, and NERC in dealing with a major reliability event to assess the role(s) played and compliance with stated practices, procedures, and controls;
- Conducted telephone interviews throughout the course of the audit to clarify and understand WECC practices, procedures, and controls relevant to the audit. Also, used interviews to corroborate evidence already gathered through other means; and
- Reviewed approximately 100GB of WECC staff emails.

Specifically, Audit staff:

### **Accounting of Non-statutory Activities**

- Interviewed WECC's Controller;
- Interviewed Director of WREGIS;
- Reviewed current, past, and draft budgets;
- Reviewed charters and meeting minutes of WECC member committees; and
- Reviewed Commission orders addressing WECC's functions.

### **Assumption of the Interchange Authority Function**

- Reviewed correspondence between WECC and NERC related to the registration of WECC as the IA for the Western Interconnection;
- Reviewed contracts between WECC and Balancing Authorities;
- Reviewed WECC's budget for costs related to the IA function; and
- Reviewed WECC staff email to understand the process used to determine how WECC chose to register as the IA.

### **Creation of the WECC Compliance Committee**

- Reviewed minutes of WECC Board and committee meetings;
- Reviewed draft and Board approved charters as well as meeting minutes for the WCC;
- Interviewed WECC management and WECC Board members involved in the formation of the WCC; and
- Reviewed emails of WECC staff for any inappropriate contact with registered entities.

**Backlog Reduction Plans**

- Reviewed WECC staff emails dealing with development of the plans, internal deliberations, and correspondence with NERC staff;
- Interviewed WECC staff involved in the development of the backlog reduction plans;
- Obtained and reviewed copies of completed mitigation plans accepted using the backlog reduction plans; and
- Reviewed correspondence between WECC and NERC relating to WECC's backlog reduction plans.

**Procedures to Address Inappropriate Communication**

- Interviewed WECC staff to identify risk areas of inappropriate communication;
- Reviewed Governance and Nominating Committee meeting minutes to determine the progress of WECC's plan to address inappropriate communication; and
- Reviewed emails to determine the flow of confidential CMEP information within WECC.

### **III. Findings and Recommendations**

#### **A. WECC's Accounting for Section 215 Funding**

Audit staff found the following deficiencies in WECC's accounting practices in support of its section 215 funded activities under the RDA:

- WECC did not adequately segregate monies in its books and records received for statutory and non-statutory functions. For example, WECC did not segregate monies associated with the IA function from statutory functions;
- Although the Commission did not approve WECC's performance as an IA as a statutory function, WECC used statutory monies to pay its employees for time and expenses associated with carrying out the IA function;
- The ability to fund the costs associated with the IA function that WECC is carrying out is not clearly specified Exhibit E to the RDA. In addition, Audit staff has concerns that WECC may be including funding for other functions and activities that WECC may consider statutory, but for which WECC has not yet received Commission approval for such treatment; and
- Costs for the Western Renewable Generation Information System (WREGIS), an acknowledged non-statutory activity, were not accurately tracked to prevent cross-subsidies from occurring.

#### **Pertinent Guidance**

The Commission rejected "as inconsistent with FPA section 215, WECC's proposal to assess members for the costs of non-statutory activities."<sup>14</sup>

The Commission also found that it "would be improper to require interested stakeholders to fund other activities as a condition to their membership in WECC. WECC may collect funds through other means (such as user fees), or may charge special membership fees to those who either choose or are required to participate

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<sup>14</sup> Delegation Agreements Order at P 458.

in non-FPA section 215 activities, however, it may not require contributions from those who do not.”<sup>15</sup>

Provision 5, Non-Statutory Activities, of Exhibit E to the WECC-NERC Delegation Agreement provides that:

WECC will maintain accounts for funding and expenses associated with all non-statutory activities that are separate from the funding and expenses associated with statutory activities. Currently, the only non-statutory activity relates to the Western Renewable Generation Information System (“WREGIS”), a system to identify and track renewable energy credits. WECC maintains separate accounts for the funding and expenses of WREGIS, and the program is currently funded through the California Energy Commission. WECC agrees that no costs of non-statutory activities are to be included in the calculation of WECC’s dues, fees, and other charges for its activities pursuant to this Agreement. Instead, as provided in Bylaws section 12.3, any fees to fund non-statutory activities are voluntary and not a condition for membership.

### **Background**

The concerns of the Audit staff on this issue fall into two major areas. The first concern relates specifically to recent Federal grant monies WECC applied for, and expects to receive, for member-service activities that appear to be beyond the scope of approved statutory funding. Audit staff believes that proper accounting policies and procedures need to be put into place to segregate the costs for these member-service activities funded by the grants from the costs for those activities that have received Commission approval to be included under section 215 funding. For these reasons Audit staff believes that WECC needs to conduct a thorough, detailed breakdown of all of its activities to properly identify and fund both its statutory and non-statutory activities.

The second concern relates to the transparency of activities that WECC performs on behalf of its members (i.e., member-service functions) that go beyond the specific activities that the Commission has approved for statutory funding purposes. As will be discussed in more detail under Findings, section B of this

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<sup>15</sup> *Id.* at P 459.

Audit Report, the issue of WECC performing the IA function falls into this category. Audit staff is concerned with the lack of specificity in identifying such activities in Exhibit E to the RDA, as well as in the budgets presented to the Commission.

The Commission allowed WECC to charge user fees to those members who either choose, or are required, to participate in non-section 215 activities. Audit staff determined that WECC has construed this permission to allow it to charge user fees for such activities as specialized training (i.e., operator training beyond the normal training offered to all members under the RDA), but not to require conducting any true-up accounting to ensure that any cross-subsidies are not occurring. Audit staff is concerned that WECC has applied the Commission's authorization to include some specifically identified non-FPA section 215 activities (i.e., non-statutory activities) too broadly and may result in member-service activities receiving section 215 treatment without appropriate Commission approval.

Although WECC is now implementing an accounting system that uses the NERC system of accounts, at the time the audit commenced, WECC did not segregate accounts pursuant to that system. However, WECC performed a translation of its accounting codes into NERC's system of accounts for budget filings.

### **Federal Grant Monies**

WECC has submitted proposals in response to two separate Funding Opportunity Announcements (FOA) issued by the Department of Energy (DOE). The America Recovery and Reinvestment Act of 2009 (ARRA) directed the DOE to facilitate interconnection-wide transmission analysis and planning. WECC, thinking it was in the best position to respond in the Western Interconnection, formed a Transmission Expansion Policy and Planning Committee (TEPPC) task force in March 2009 in anticipation of the FOAs. After the first FOA was announced, the TEPPC task force prepared a white paper for review by the WECC Board of Directors. After presentation of TEPPC's proposal, WECC's Board approved authority for WECC to apply for funding from the DOE for transmission expansion planning. WECC submitted its proposal to the DOE on August 13, 2009, and announced on December 18, 2009, that WECC was awarded \$14.5 million in funding.

WECC views the proposal as a means to:

- Expand the capability of planning processes in the West;

- Extend the current TEPPC processes;
- Improve coordination of sub regional groups and WECC planning processes;
- Provide input to other critical processes (siting, rating, cost allocation); and
- Keep decision authority over transmission planning with TEPPC and WECC.

WECC's proposal provided a breakdown of possible budgets for the groups that will be responsible for the transmission planning studies. For the duration of the funding available through the DOE, WECC's budget related to the FOA was forecasted to be \$6,146,800; the budget for Sub-regional Planning Groups would be \$2,140,000; the budget for Scenario Planning Steering Group would be \$2,833,600; the budget for Non-Governmental Organizations would be \$2,452,800; the budget for the Western Region University budget would be \$2,601,000; and the budget for the Western Interconnection Resource Planner Forum would be \$160,000. WECC stated in its proposal that it intends to "designate a full-time administrator to manage the day-to-day operations of activities funded by the FOA." WECC also stated in its proposal that it "will use a Government Accounting Office (GAO) approved accounting firm to manage the disbursement of all funds." The FOA specifies that deliverables from the funding are due in June 2011 and June 2013. The funding ceases after 2013.

Audit staff has questions regarding how the tracking of costs and payments for the expansion in transmission planning activities will be segregated from the costs of Commission-approved activities included in WECC's RDA. Currently, the costs for the TEPPC activities are included in WECC's RDA as a part of its Reliability Assessment and Performance Analysis responsibilities. Further, Audit staff has concerns about whether the funds will be separated from current activities being performed by WECC through its TEPPC. Specifically, Audit staff questions the treatment of funds allocated to WECC as section 215 funding and how funding for the audits of the DOE funds and the administrator of the funds will be allocated.

The second FOA issued by the DOE relates to the Western Interconnection Synchrophasor Project (WISP). WECC announced on October 27, 2009, that it received funding for this project. The project involves the commitment of \$53,888,000 by entities in the Western Interconnection to be matched by the DOE FOA to facilitate investment in "Smart Grid" technologies. The total estimated spending would be \$107,776,000 and includes the following entities in the Western Interconnection in addition to WECC: Bonneville Power Administration, California ISO/California Energy Commission/Electric Power Group, Idaho

Power Corporation, NV Energy, Southern California Edison, and Salt River Project. As stated in DOE's second FOA, the goals of WISP include large-scale outage avoidance, increased transmission use, increased use of intermittent renewable generation, reduced capacity firming costs for intermittent generation and improved cyber security. The project is intended to enhance the situational awareness of WECC's Reliability Coordination Offices. WECC's role as the RC has been approved in the RDA, but Audit staff has concerns about the accounting for the WISP grant funds that are similar to its concerns about WECC's application for funds for transmission expansion planning as detailed above.

### **WECC Accounting Treatment of the IA Activities**

Despite WECC's initial assertions to Audit staff that WREGIS is the only non-statutory activity WECC performs, the Audit staff's analysis revealed that WECC has expressed internal concerns regarding how the IA function would/should be funded (i.e., whether it qualified for statutory funding). WECC's CEO indicated (in the minutes of the October 2008 Operating Committee meeting) that she believed that funding for the primary tool needed to perform the IA function, the WECC Interchange Tool (WIT), may not be a funding issue for 2009, but could be for 2010. Further, a position paper, identified in an email sent among WECC management on October 31, 2008, addressed the question of whether the IA function if performed by the WECC Reliability Coordinator (WECC RC) would be covered by section 215 funding. The document noted that it is impossible for WECC to know the likelihood of the IA function being covered by section 215 funding, observing that FERC had been reluctant to designate the RC function as a statutory activity to be funded through the WECC and NERC budgets pursuant to FPA section 215, and that resistance to funding for the IA function is to be expected. Another letter exchanged among WECC management in early October 2008 indicated that WECC intended to move funding for the IA function from section 215 to the Balancing Authorities (BAs) in 2010, but that it could happen sooner if NERC or FERC take regulatory action.

During the Audit staff site visit to WECC in June 2009, interviews were conducted to determine whether WECC accurately accounts for the IA function. WECC's CEO said that WECC intends to continue treating the IA function as statutory, and that the amount was small compared to WECC's budget and only requires the equivalent labor of half a full-time equivalent employee. However, WECC's accounting system did not reflect the allocation of time spent on this function.

**WREGIS Accounting Issues**

Audit staff also has concerns regarding the process by which WECC accounts for resources dedicated to non-statutory functions. WECC contends that its only non-statutory activity is WREGIS, its system to identify and track renewable energy credits.<sup>16</sup> Audit staff reviewed the accounting treatment for WREGIS and believes the current accounting methodology for WREGIS, which is based upon rough estimates, could be refined without significant costs. The current allocation of overhead costs of WECC to WREGIS should be subject to periodic review and true-up to avoid any cross-subsidies. Prior to the commencement of the audit, WECC did not have an accounting system that could be used for this purpose. WECC's Bylaws in Exhibit E state that WECC shall follow NERC's prescribed system of accounts; however, WECC staff indicated during the Audit staff's January 2009 site visit that WECC's current process was not consistent with the NERC accounting process. On December 10, 2009 WECC notified Audit staff that WECC has recently put a more accurate accounting system in place. The new system, which is also used by NERC and several other REs, had a go-live date of July 1, 2009.

The Audit staff has concerns regarding the funding of a myriad of WECC's activities on behalf of its members, including whether WECC will put into place accounting policies and procedures that allow WECC to identify the costs of each of these new or expanded activities, and ensure that the costs and grant funding are properly allocated between statutory and non-statutory activities. Unless and until the RDA is modified by the Commission to identify costs and funding for new or expanded activities as statutory, WECC should have policies and procedures to ensure that the section 215 funding mechanism does not include any non-statutory activities and that there are not any cross-subsidies.

**Recommendation**

We recommend that WECC:

1. Identify how WECC intends to segregate grant money received for statutorily funded tasks being performed by WECC and funded under section 215;

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<sup>16</sup> WREGIS is currently funded by the California Energy Commission.

2. Segregate the costs of performing the IA function from section 215 funding unless, and until, FERC has approved these costs for section 215 recovery;
3. Provide a detailed list of all activities performed by WECC that are not specifically included as statutory or non-statutory activities in the RDA Exhibit E, including details of any expansion of previously approved functions;
4. Revise its existing accounting system to properly classify and track statutory and non-statutory activities, and funding for these activities; and
5. Adopt commonly accepted policies and procedures used to track actual expenditures for shared service costs, overhead costs, WECC RE staff hours, and associated costs for statutory and non-statutory functions.

**B. WECC's Assumption of the Interchange Authority Function**

WECC assumed the IA function as a statutory function without Commission approval.

**Pertinent Guidance**

In Order No. 672, the Commission stated that: “section 215 of the FPA provides for federal authorization of funding limited to the development of Reliability Standards and their enforcement, and monitoring the reliability of the Bulk-Power System. However, the ERO or a Regional Entity is not precluded from pursuing other activities, funded from other sources.”<sup>17</sup>

The ERO Certification Order requires that a Regional Entity engaged in non-statutory activities list these activities in Exhibit E of its Delegation Agreement.<sup>18</sup> As the Commission explained in the Delegation Agreements Order: “The identification of non-statutory activities performed by a Regional Entity is necessary to ensure that such activities do not compromise the Regional Entity’s oversight role or independence or present a conflict of interest regarding its oversight of transmission operators.”<sup>19</sup>

In Order No. 672-A, the Commission found that the ERO can collect a Commission-approved assessment of dues, fees or charges for all activities performed pursuant to section 215 of the FPA.<sup>20</sup> The Commission also stated that it will consider what a permissible statutory activity is when shown a specific proposal.<sup>21</sup>

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<sup>17</sup> *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204 at P 202, *order on reh’g*, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006).

<sup>18</sup> *North American Electric Reliability Corporation*, 116 FERC ¶ 61,062, at P 173 and P 184 (2006), *order on reh’g and compliance*, 117 FERC ¶ 61,126 (2006).

<sup>19</sup> Delegation Agreements Order at P 532.

<sup>20</sup> Order No. 672-A at P 65.

<sup>21</sup> *Id.*

## **Background**

On July 14, 2008, NERC's Manager of Organization, Registration, and Certification notified the Regional Entity Managers that Interchange Authority (IA)<sup>22</sup> had been added as a Registered Entity function on February 5, 2008. NERC's July 14, 2008 letter stated that a software developer (i.e., OATI) had previously performed the function now designated as the IA function. However, OATI was ineligible to register as the IA, because that company was not an owner, operator, or user of the Bulk-Power System. NERC delegated the responsibility for identifying the organizations to be registered to the eight Regional Entities. On September 4, 2008, WECC sent a letter to NERC's Vice President and Director of Compliance requesting an extension to comply with the IA registration timeline.

In this letter, WECC stated that Balancing Authorities (BAs) in the Western Interconnect are the owners, operators, and users of the Bulk-Power System that benefit from the OATI tool, but they do not use the tool to perform the IA functions. Further, the BAs do not have direct contractual authority over the IA functions OATI performed, and consequently are not involved in the performance of the IA functions. On the other hand, WECC holds the contract with OATI for the Western Interconnection and is therefore responsible for the oversight of OATI's performance under the contract. Based upon this fact pattern, WECC found it difficult to determine what entity(ies) should have final responsibility to register as the IA.

On September 18, 2008, NERC denied WECC's request for an extension. NERC response to WECC's request included, among other things, language from Order No. 693 where the Commission found there was "sufficient clarity regarding the nature and responsibilities [for the IA] function for it to be implemented[.]"<sup>23</sup> Further, NERC observed that the Commission found in Order

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<sup>22</sup> The IA function coordinates the requests by Purchasing and Selling Entities to arrange transmission service requests by interacting with the Balancing Authorities and the Transmission Service Providers as well as the Reliability Coordinator.

<sup>23</sup> *Mandatory Reliability Standards for the Bulk-Power System*, FERC Stats. & Regs. ¶ 31,242, at P 802 (2007) (Order No. 693), *order on reh'g*, 120 FERC ¶ 61,053 (2007) (Order No. 693-A).

No. 693 that “withholding approval of INT Reliability Standards pending further clarification on this matter would create an unnecessary gap in the coverage of the Reliability Standards that potentially could threaten the reliability of the Bulk-Power System.”<sup>24</sup>

NERC dismissed WECC’s claim that an extension of time would not damage reliability due to OATI’s handling of IA-required functions on the ground that the OATI software is only one tool used by the BAs for performing IA tasks. NERC said if OATI software were unavailable, the BAs could still perform IA functions manually. Also, since OATI is not a registered entity, no registered entity would be accountable as an IA within WECC during an extension of time. NERC told WECC that if it did not receive IA registration documents within 30 days of the date of the letter (September 18, 2008), NERC would begin registering the appropriate entities in the WECC region as IAs.

On October 6, 2008, WECC sent NERC another request for an extension of time to register one or more entities as the IA in the Western Interconnect. WECC’s Board of Directors met and decided that WECC would register as the IA and execute agreements with BAs governing the relationship between WECC and the BAs as to the IA function. On October 13, 2008, NERC approved WECC’s request for an extension of time, provided that WECC diligently complete contracts between WECC and the BAs in the Western Interconnection, submit a registration for WECC as the IA when the first agreement is completed, submit notices of any BAs that choose not to sign an IA agreement with WECC, and send updates to NERC on the first days of November and December of 2008.

In November and December 2008, WECC executed contracts with 32 of the 33 BAs in the WECC region. The remaining contract was executed in February 2009. WECC began functioning as the IA for the Western Interconnect on December 9, 2008. In a January 16, 2009 letter from NERC, NERC informed WECC that it was listed in the NERC Compliance Registry as the IA within the WECC footprint and had assumed compliance responsibility for the BAs with whom WECC signed contracts.

Audit staff has concerns about WECC’s registration as the IA. The Commission granted WECC authority to perform the functions delegated to it as stated in its RDA with NERC. In addition, the Commission provided express

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<sup>24</sup> *Id.*

exceptions to allow recovery of additional costs for specific programs listed in Exhibit E to the RDA. The IA function was neither listed in that exhibit as filed, nor had WECC sought to amend the RDA to include this activity as a statutory activity or to identify it as a non-statutory activity. Therefore, it is improper for WECC to be performing the IA function as a statutory activity and to recover its costs for performing this function under section 215, absent explicit approval by the Commission.

### **Recommendation**

We recommend that WECC:

6. Submit a revised Exhibit E of the NERC-WECC RDA to the Commission requesting a review of whether WECC's performance of the IA function is a statutory function.

**C. WECC's Compliance Committee**

During the audit period, the structure of the WECC Compliance Committee (WCC) did not provide sufficient safeguards to ensure the independence of WECC's compliance program and the protection of confidential compliance information against improper disclosure. WECC did not seek guidance from the Commission on this issue, despite the concerns the Commission previously raised regarding compliance committees.

**Pertinent Guidance**

Section 403.1, Independence, of the NERC Rules of Procedure provides that:

Each regional entity's governance of its compliance enforcement program shall exhibit independence, meaning the compliance enforcement program shall be organized so that its compliance monitoring and enforcement activities are carried out separately from other activities of the regional entity. The program shall not be unduly influenced by the bulk power system owners, operators, and users being monitored or other regional entity activities that are required to meet the reliability standards.

Section 403.6.2 of the NERC Rules of Procedure states:

Regional entity compliance enforcement program staff shall have the authority and responsibility to investigate, audit (with the input of industry experts or regional members), make initial determinations of compliance or noncompliance, and levy penalties and sanctions without interference or undue influence from regional entity members and their representatives or other industry entities.

Section 6.12 of the WECC bylaws provides that the Board can delegate authority to the Chief Executive Officer or any Board committee through a resolution.<sup>25</sup>

Sections F and G of the Committee Composition and Governance, Membership section of the WCC charter state:

F. To allow Committee members to receive confidential information related to ongoing compliance cases, each Committee member shall sign a non-disclosure agreement with WECC that specifies the member's responsibilities with respect to confidential information and indicates how written confidential materials will be marked for ease of identification by members of the Committee and disposal of the materials.

G. Committee members who are employed by or receive income from Registered Entities which are subject to enforcement under the CMEP must disclose those relationships to the Committee and update that disclosure quarterly.

The WCC charter states that:

The purpose of the Committee is to provide Board of Directors (Board) oversight of the WECC Compliance function under the delegation agreement from the North American Electricity Reliability Corporation (NERC). The WECC Compliance Committee (WCC) assists WECC Compliance staff in carrying out its responsibilities under the NERC – WECC Delegation Agreement. WCC has not been created to direct the day to day work of the WECC Compliance staff but rather to provide WECC Management, particularly the Vice President of Compliance, the opportunity to maintain healthy communication with the WECC Board concerning the challenges and the policy issues that staff must address in the implementation of the Compliance Monitoring and Enforcement Program (CMEP), which is part of the Delegation Agreement.

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<sup>25</sup> WECC Bylaws section 6.12. *See also* section 7.7.3 and Appendix A1-A3.

This communication between staff and the WCC may include sharing confidential information with members of the WCC, subject to agreements requiring those members to maintain the confidentiality of such information as required by NERC Rules of Procedure, the Delegation Agreement, or FERC Orders. WECC's General Counsel ensures that such agreements adequately inform members of the WCC of their responsibilities regarding the use of any such information and the length of time that such information must be kept confidential.

### **Background**

On May 1, 2009, WECC notified Audit staff by telephone that WECC's Board approved the creation of the WCC as a Board committee. WECC provided Audit staff with material related to the Board's initial action. Upon reviewing the charter and supporting materials (which included the minutes of relevant committee meetings), Audit staff expressed to WECC serious concerns about the impacts that the creation and operation of this committee might have upon independence of the WECC compliance staff and the disclosure of confidential CMEP information to inappropriate parties.

According to the WCC charter, the WCC is composed of seven members, all of which are members of the WECC Board of Directors. The WCC charter states that the ideal mix of representation on the WCC would be: two members who are Non-Affiliated Directors, one each from the three Electric Line of Business Classes (i.e., classes 1, 2, and 3), and one each from the End-User representatives and the State or Provinces. However, the WCC charter clearly indicates that this representation "is a guideline rather than a requirement." The chair and the Vice Chair of the Compliance Hearing Body are *ex officio* members. The charter for the WECC Compliance Hearing Body indicates that the Chair and the Vice Chair could be either non-affiliated Board members or Board members that are affiliated with members in the electric line of business. Currently the WCC Chair is a State regulator and the Vice Chair is a representative from a public utility district (i.e., an affiliated member). However, the affiliations of these positions are not fixed.

During the April 2009 WECC Board of Directors meeting, when the WCC charter was approved, there was discussion as to how the WCC should address NERC's desire for compliance functions to report to independent directors. However, it is unclear how the WCC charter is consistent with section 403 of the NERC Rules of Procedure. As mentioned below, this concern prompted at least

one WECC Board member to vote against the creation of the WCC in its present form.

Audit staff acknowledges that this committee composition may hold some potential for oversight of CMEP activities by a more independent body. However, Audit staff maintains that its concerns regarding the current structure need to be addressed.

After its initial review of materials provided by WECC, Audit staff conducted a conference call with WECC to disclose its concerns in the following areas:

- A non-affiliated WECC Board member led a discussion during the February 2009 meeting of the Governance and Nominating Committee (GNC) in which he presented the registered members' case for the creation of a Compliance Committee. The justification was to address the concerns of registered entities in the Western Interconnection. In particular these registered entities wanted:
  - A greater control over the Reliability Standard Audit Worksheets used in the compliance audits;
  - An increased role in the interpretation of reliability standards when assessing compliance findings; and
  - A lessening of confidentiality in the CMEP program.
- The minutes of the March 2009 GNC meeting reiterated some of these same concerns, stressing the perceived need for less confidentiality and the other aforementioned registered entity concerns. In addition, the minutes raised issues of the authority that the proposed Compliance Committee would have to resolve "disagreements" and "interpretations" between the proposed Committee and the WECC RE staff responsible for the CMEP.
- The WECC CEO counseled to defer the creation of the committee until "the completion of FERC's audits of TRE and SPP." However, the reasons for such deferral were not provided in the minutes.

In response to a request by the Audit staff regarding the need, or appropriateness, for WECC to consult NERC or FERC for guidance prior to creating this new committee, WECC replied:

WECC is not aware of a need to seek approval of a governance committee that does not alter the terms of the delegation agreement.

The WECC Board is the governing authority for WECC and responsible for the implementation of the Delegation Agreement. The WECC Compliance Committee (WCC) was not created to direct the day to day work of the Compliance Staff. The WCC was created to provide better communication between Compliance Staff and the Board on challenges and policy issues related to the implementation of the Compliance Monitoring and Enforcement Program (CMEP). The WCC will monitor Compliance Staff's performance relative to the expectations outlined in the CMEP, provide policy guidance and assistance to the Regulatory Subcommittee regarding comments to NERC and FERC, and make recommendations to the Board, as necessary. All of these activities are related to the Board's current responsibilities under the Delegation Agreement.

WECC's response did not adequately address Audit staff's concerns. WECC did not address the issue of registered entities' desire for direct involvement in the CMEP process, clearly expressed in the GNC meeting minutes. Nor was the issue of possible disclosure of confidential CMEP data mentioned. The explanation of the manner in which the WCC will "monitor" the CMEP was vague. Further, WECC responded that "monitoring" was anticipated to require as-yet unspecified, conflict of interest procedures for WCC members that are currently not required of other Board members. Thus, it appears that while "current responsibilities" may stay constant, the manner in which the responsibilities are exercised may be significantly altered, with consequent impacts upon independence concerns.

In a conference call with WECC, Audit staff stressed its concerns related to the need for WECC to maintain its independence from the registered entities while performing its functions as NERC's agent under its RDA. Audit staff pointed to the GNC February and March 2009 meeting minutes with the clear statements that the WCC was intended to satisfy the goals of the registered entities with respect to the WECC compliance program as posing, at the very least, a threat to its independence from the registered entities within WECC's footprint. Audit staff pointed WECC to the Commission's concern regarding the involvement of the FRCC stakeholder Compliance Committee in the activities of the FRCC compliance staff.<sup>26</sup> Audit staff discussed the process by which the Commission has sought to reduce the role of, and ultimately seek the elimination of, the FRCC

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<sup>26</sup> Second Delegation Agreements Order at P 252.

Compliance Committee's review of compliance staff's findings.<sup>27</sup> These directives were intended to bring the FRCC CMEP into a position of greater independence from the registered entity stakeholders. Unlike the FRCC stakeholder Compliance Committee, the WCC is composed of WECC board members. Nonetheless, Audit staff indicated that the current charter of the WCC may lack sufficient measures to protect against the problems of WECC compliance staff's independence of the RE and confidentiality of CMEP information.

A subsequent site visit by Audit staff revealed that the manner in which WCC will perform its duties is a concept in flux. At times, WECC portrayed the WCC as merely a high-level advisory body, with a smaller number of members than the Board and therefore capable of meeting more frequently than the Board. However, at other times WECC presented the WCC as having a more expansive purpose, enhanced authority, and access to confidential information.

A WECC presentation made to Audit staff during the second site visit and interviews with WECC Board members and RE staff members, revealed several areas of concern:

- A Board member relayed concerns that the RE had acted on NERC-related matters without the pre-approval of the members. The Board member further elucidated his concerns by stating that such independence needed to be curbed. The Board member indicated that members felt the RE did not seek sufficient input or approval before submitting materials to NERC. The Board member viewed WCC as a means of achieving these ends.
- Another Board member expressed concern that segments of the registered entities desired to "punish" the compliance staff for not adequately "pushing back" against NERC directives. He stated that this desire motivated registered entities to seek the establishment of the WCC.

These perceptions illustrate a significant desire by some registered entity members to limit the ability of the WECC RE from exercising a strongly independent CMEP program. Consequently, Audit staff inquired whether WECC had sufficient safeguards. In response to these concerns, WECC's general counsel

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<sup>27</sup> *Id.*

stated that its bylaws prohibit a committee from acting independently of the Board. However, WECC's bylaws in section 6.12 demonstrate that it is possible for the WCC to have specifically delegated authority granted it to act autonomously from the Board. The WCC charter itself indicates the same potential transfer of authority. The Purpose/Responsibilities section of the WCC charter concludes with the summary provision that the WCC can "perform such other functions as the Board delegates."

With regard to Audit staff concerns related to the improper disclosure of confidential CMEP information, the evidence reviewed by Audit staff was troubling. The relevant language of the WCC charter is ambiguous. In particular, the WCC charter indicates that enhanced confidentiality requirements were being sought for WCC members. However, the WECC staff was unable to explain to Audit staff the nature of the confidential data that would be encompassed by the term "confidential information." Audit staff expressed concerns that the WCC might result in the compromise of confidential CMEP data. In fact, the minutes of the October 21, 2009 WCC meeting reflected that WECC's Managing Director of Compliance provided an update of settlements approved by NERC. It is not clear from the minutes whether she presented an overview of these settlements or discussed the provisions of specific settlements. Nor do these minutes indicate whether the WCC will be active in overseeing settlements (something that would be inappropriate given the functions of the WCC). It is also not clear whether she divulged confidential information.

The WCC charter contains a disclosure of conflicts provision. However, other than providing that all members comply with the WECC Standards of Conduct, the charter does not state what action, if any, may be required to address a real or perceived conflict. Rather section 3(g) of the WCC charter merely states that "the WCC chair *may ask* members of the WCC not to participate." (Emphasis added.) While the WECC Standards of Conduct provide guidelines for Directors with real or perceived conflicts of interest, there are no required actions when such conflicts arise.

Audit staff recognizes that the WCC will be composed of WECC Board members. However, Audit staff believes that the WECC compliance program must have independence in fact and independence in appearance. Since some members of the WCC are, and will be, affiliated with users, owners and operators of the Bulk-Power System, Audit staff maintains that safeguards to address independence concerns are appropriate.

During the June 2009 site visit, in response to Audit staff questions about the WCC, the CEO gave verbal assurances that there would be:

- No company-specific compliance information conveyed to the WCC;
- No confidential data conveyed to the WCC that was not already being conveyed to the full Board; and
- Only advice and no direction provided by the WCC.

However, the language in the Purpose/Responsibilities section of the WCC charter provides that confidential information, requiring confidentiality agreements not required by other Board members, will be provided to the WCC. Furthermore, Audit staff notes of interviews conducted during the same site visit indicate that at other times the CEO used vague language, shifted her position several times, and hedged her commitments. Audit staff has no reason to believe that the CEO was seeking to dissemble in any manner. Audit staff is of the opinion that the ambiguity arises due to the as-yet undefined role that the WCC may eventually play. Nevertheless, Audit staff is unable to reconcile the stated need to have greater confidentiality protection for information provided to the WCC than for information provided to the Board with the CEO's statement that no confidential information will be presented to the WCC than is presented to the WECC Board. Moreover, given the strong sentiments expressed by WECC members in the GNC, Audit staff believes it is important to make strong and clear statements in the charter to maintain CMEP independence and to protect confidential data.

While on a site visit to WECC in June 2009, Audit staff discovered in an interview with an independent member of WECC's Board of Directors that (i) the Board's vote to create the WCC was extremely close and (ii) that all Class 1 members (i.e., large transmission system owners) voted against the formation of the WCC. When neither the WECC staff nor the independent Board member could shed any light on the reasons for the dissent, Audit staff conducted an independent survey of the Class 1 Board members.

In response to the Audit staff request for information, Audit staff identified the following areas of concern:

- One Board member voted against the WCC so WECC's compliance staff could have the opportunity to mature and work through its compliance backlog. He noted that WECC's compliance staff had struggled to keep up, but had begun to reduce its backlog. The Board

member also noted the belief that the WCC would probably be more of an obstacle than a help.

- A second Board member voted against the WCC due to confusion about the scope of the WCC. The concern was that the WCC would be involved in reviewing specific CMEP actions before they were approved by the WECC Compliance Officer. This Board member voted against the proposed WCC charter and recommended that the charter undergo an additional review.
- A third Board member contended that the WCC charter lacked clear scope and characterized WECC committee structure as difficult at best. The Board member thought the WCC charter needed to be defined more clearly and address whether the WCC will have any involvement over penalties or compliance issues.
- Another Board member expressed two reasons for not supporting the formation of the WCC at the time it was brought to a vote. The first reason was that the reorganization of the compliance staff at WECC should be given the opportunity to perform so concerns that led to the drafting of the WCC charter might make the formation of the WCC moot. Secondly, the Board member felt that more clarity was needed as to whether the WCC addressed NERC's desire to have compliance programs report to independent directors.

Based upon this survey, within WECC's Board there were concerns that the creation of WCC may involve problems regarding confidentiality of CMEP data, possible adverse involvement in CMEP activities, and sensitivity to addressing the WECC compliance program's independence in the WCC's oversight of the CMEP. In an effort to address these concerns, WECC had the members of the WCC execute confidentiality agreements between July 30, 2009 and August 23, 2009.

During phone interviews conducted during the June 2009 site visit, in response to Audit staff's expressions of concern in these areas, one Board member argued that the proposed initial chair of the WCC would be a person above reproach. Audit staff believes that to trust in the integrity of a person currently occupying a position of authority, when important structural concerns have not been addressed, is not a prudent course of action. Therefore, despite the degree of comfort that the current chair of the WCC may bring, Audit staff believes that steps must be taken to ensure that the WCC cannot adversely impact the independence of the CMEP process and the confidentiality of the CMEP data.

The audit team recognizes the benefits that having a more manageable entity provide oversight of the CMEP program would provide. However, in order to provide such oversight, information may be needed that may raise issues if shared with users, owners and operators of the Bulk-Power System. Therefore, adequate measures to ensure independence and confidentiality need to be in place to allow the WCC to function as an effective oversight entity.

### **Recommendation**

We recommend that WECC:

7. Revise the WCC charter to ensure independence of the CMEP function;
8. Revise the WCC charter to ensure the confidentiality of CMEP data;
9. Submit the Board-approved WCC charter along with details of how the WCC relates to RDA activities to ensure the independence and confidentiality of the CMEP to the Audit staff for its review;
10. Provide a written narrative explaining how WECC intends to maintain or enhance the independence and confidentiality of the CMEP when considering any proposed changes to the WCC charter, including a process whereby WECC will inform the Commission of such impacts; and
11. Develop a procedure to prevent the disclosure of confidential information.

**D. WECC's Backlog Reduction Plan**

WECC developed and implemented a plan to reduce its backlog of mitigation plans during the summer of 2008. This plan was not approved in advance by NERC. NERC's subsequent review indicated that the plan was not consistent with its CMEP. Although WECC terminated the plan upon receiving an unfavorable opinion from NERC, potential problems that resulted from its initial implementation have not been addressed.

**Pertinent Guidance**

In Order No. 693, the Commission provided guidance to NERC and the industry on determining penalties during the first six month period of mandatory and enforceable reliability standards (i.e., June 18, 2007 – December 31, 2007):

The Commission believes that the goal should be to ensure that, at the outset, the ERO and Regional Entities can assess a monetary penalty in a situation where, for example, an entity's non-compliance puts Bulk-Power System reliability at risk. Requiring the ERO and Regional Entities to focus on the most serious violations will allow the industry time to adapt to the new regime while also protecting Bulk-Power System reliability by allowing the ERO or a Regional Entity to take an enforcement action against an entity whose violation causes a significant disturbance. Our approach strikes a reasonable balance in ensuring that the ERO and Regional Entities will be able to enforce mandatory Reliability Standards in a timely manner, while still allowing users, owners and operators of the Bulk-Power System time to acquaint themselves with the new requirements and enforcement program. In addition, our approach ensures that all users, owners and operators of the Bulk-Power System take seriously mandatory, enforceable reliability standards at the earliest opportunity and before the 2007 summer peak season.

Order No. 693 at P 224. Nonetheless, WECC's processing of violations during the first six months of mandatory and enforceable reliability standards was not timely.

NERC itself acknowledges that the backlog of alleged reliability standard violations to be processed remains problematic.<sup>28</sup>

WECC's CMEP section 6.3, Timetable for Completion of Mitigation Plans, provides in pertinent part that:

If the Mitigation Plan extends beyond the next applicable reporting/assessment period, sanctions for any violation occurring during the implementation period will be held in abeyance and will be waived if the Mitigation Plan is satisfactorily completed.

### **Background**

A letter to NERC dated November 20, 2008 from the then-Vice President of Compliance (VPC) at WECC states that WECC had 3,359 pre-June 18, 2007 violations and 1,557 post-June 18, 2007 violations. Audit staff had a March 24, 2009 telephone conversation with the former VPC in which he stated that the backlog resulted from WECC's extremely effective outreach program to the registered entities before the reliability standards became mandatory in the United States. Many entities made self-reports of possible violations to WECC and submitted mitigation plans under which they would take steps to come into compliance. As a result of the significant backlog, the former VPC stated that WECC's CEO told him that they were "betting WECC" on their ability to reduce the backlog in mid-2008.

Corresponding to the timeframe indicated by the VPC, WECC's then-Manager of Compliance Audits drafted a proposal to reduce the backlog of mitigation plans that needed WECC's review. The proposal was submitted to the VPC for review on August 6, 2008. The initial draft of the plan detailed the process by which WECC would accept completed mitigation plans based on the attestation of the registered entities' officers and verify compliance at the next scheduled audit, spot check, or investigation. This process departed somewhat from CMEP section 6.5 relating to mitigation plans, which provides that an RE reviews a submitted mitigation plan and may reject it or suggest changes to it. CMEP section 6.6 provides that, upon receiving a certification of a registered

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<sup>28</sup> *North American Electric Reliability Corp.*, 129 FERC ¶ 61,040 at P 56 (2009) (referencing NERC's 2010 business plan and budget filed in Docket No. RR09-9-000).

entity that it had completed a mitigation plan, an RE shall request data and information as it deems necessary to verify that all required action in the mitigation plan have been completed and that the registered entity is in compliance with the subject Reliability Standard.

The backlog reduction plan would apply to all self-reported violations reported on or before December 31, 2007, except violations of Reliability Standards FAC-003, PER-002, PER-003, PRC-005, PRC-008, and PRC-017, and certified mitigation plans that were late. The plan was implemented during the week of August 8, 2008, and WECC intended to use the plan for all violations included in the stated criteria.

The then-Manager of Compliance Audits sent an email to compliance staff outlining the backlog reduction plan on August 14, 2008, stating the first set of violations accepted under the plan were to be sent out the next day, and that “this was thoroughly reviewed” by WECC’s General Counsel.

On September 4, 2008, WECC received a letter from NERC’s Vice President and Director of Compliance as a result of a meeting between NERC and WECC staff in Washington, DC, on August 27, 2008. The letter stated concerns about the plan, including a statement that it was a departure from current approved practices and that other Regional Entities had inquired if WECC’s plan was acceptable. NERC requested that, by September 12, 2008, WECC provide clarification of what mitigation plans were included in the plan (whether the backlog reduction plan would apply to mitigation plans submitted before June 18, 2007 and/or those submitted after June 18, 2007), the period over which the plan will be implemented, and the criteria used to select entities and standards included in the plan.

WECC received the letter from NERC after reviewing some 550 self-reported violations using the plan. An email between WECC managers on the same day WECC received the letter from NERC read “...this all went a bit too smooth.” Also, the email inquired whether WECC’s then-Manager of Compliance Audits had heard from FRCC. Someone from FRCC had indicated that an email would be coming because FRCC expressed interest in the plan.

WECC’s response to NERC provided a detailed rationale for its backlog reduction plan. WECC concluded that “based on the discretion directed by the Commission and offered by the CMEP, it is within WECC’s authority to accept the certification of compliance by the registered entities’ certifying officer as evidence that all required actions in the subject mitigation plan have been completed and that the entity is in compliance.” WECC’s response clarified that it

would verify compliance at the next scheduled compliance monitoring activity. If evidence did not support compliance at that time, the violation period would begin at that time.

WECC indicated to NERC that the plan would include both pre-June 18 and post-June 18 self-reported violations reported to WECC on or before December 31, 2007.

On October 8, 2008, NERC issued a response to WECC's explanation of its backlog reduction plan that recommended modifications to ensure the plan would be consistent with FERC requirements. Specifically, NERC questioned WECC's treatment of violation periods associated with its backlog reduction plan. WECC's plan would have the violation period start at the time the registered entity failed to successfully complete its mitigation plan. NERC correctly contended that the violation period should start from the time of the original self-report, since the violation was not properly mitigated. On November 21, 2008, WECC issued its final response to NERC regarding the backlog reduction plan. WECC's response informed NERC that, "After careful analysis of the actions required to implement the proposed modifications WECC has decided to abandon the proposal."

Based on Audit staff's review of the WECC mitigation plans, WECC's use of the mitigation response form letter associated with the backlog reduction plan ceased on September 12, 2008. This was the date NERC requested a response from WECC about its backlog reduction plan. After September 12, 2008, WECC returned to using the previous mitigation plan form letter, developed prior to the implementation of the backlog reduction plan. However, during the Audit staff's June 2009 site visit, WECC staff indicated that there is not a plan in place to address how to treat a situation where a mitigation plan was accepted under the backlog reduction plan, but later found to have not been successfully mitigated. During Audit staff's June 2009 site visit, WECC staff indicated that it had not contacted any of the registered entities that had received mitigation plan approval letters during the time period related to the backlog reduction plan to inform them how any future violations would be treated, in accordance with the guidance contained within the correspondence with NERC.

During the June 2009 site visit, WECC expressed concern when asked to explain continuing perceptions of ongoing problems in meeting its current caseloads. WECC staff members said they believed that they are "current on current" and that, in their view, the backlog was decreasing and not increasing. WECC said it does not consider a violation to be a part of a backlog so long as it is being addressed within the timelines specified in its CMEP. WECC expressed concern that different definitions were casting a bad light on its current CMEP

activities. WECC continues to work toward reducing its prior backlog and has approached the Commission with a new proposal to review violations in the future.

### **Recommendation**

We recommend that WECC:

12. Work with NERC and the Commission to develop and implement plans to properly quantify and address WECC's current caseload, and work towards preventing future backlogs; and
13. Contact the registered entities which had completed mitigation plans which were accepted under the initial backlog reduction plan, and inconsistent with WECC's CMEP and inform these entities that the violation period will start from the date of the original self-report or June 18, 2007, whichever is later, if the entity is later found to still be out of compliance.

### **E. WECC Policies for Averting and Reporting Inappropriate Communications**

WECC did not have policies and procedures to ensure against, or report any, inappropriate communication between Board members and WECC staff. Therefore, senior WECC officials did not know how to address such inappropriate communications.

### **Pertinent Guidance**

As noted previously, section 403.1, Independence, of the NERC Rules of Procedure provides that:

Each regional entity's governance of its compliance enforcement program shall exhibit independence, meaning the compliance enforcement program shall be organized so that its compliance monitoring and enforcement activities are carried out separately from other activities of the regional entity. The program shall not be unduly influenced by the bulk power system owners, operators, and users being monitored or other regional entity activities that are required to meet the reliability standards.

Section 403.6.2 of the NERC Rules of Procedure, states:

Regional entity compliance enforcement program staff shall have the authority and responsibility to investigate, audit (with the input of industry experts or regional members), make initial determinations of compliance or noncompliance, and levy penalties and sanctions without interference or undue influence from regional entity members and their representatives or other industry entities.

### **Background**

During the June 2009 site visit to WECC, Audit staff conducted several interviews of newly appointed senior members of WECC's compliance staff. During the course of these interviews, it became apparent that there was insufficient implementation of, or failure to properly train staff in, procedures related to how WECC employees should respond if inappropriately contacted by a

member, user, owner, or operator in WECC's region, and in particular, by a Board member during a compliance audit.

Interviews with WECC's Vice President of Compliance, and Managing Director of Compliance, indicated an inability to articulate the appropriate procedures to report inappropriate contact. Further, the Managing Director of Compliance indicated that she did not know of any manner in which a member could exercise undue influence on an employee at WECC. Audit staff believes that this indicates a serious lack of awareness of concerns for the independence of the CMEP program. Given the senior positions of these staff members, this was a matter of serious concern to Audit staff.

WECC's Manager of Enforcement was asked about his role in the settlement process and his concerns about inappropriate influence by Board members in the process. He indicated that there had been occasions where a Board member had been a participant in the settlement process for his employer. The Manager of Enforcement stated that he felt that this was inappropriate. When questioned whether Board members should participate in the settlement process, he responded that he thought it would be more appropriate for the Board member to recuse themselves from the process to prevent any actual or perceived undue influence.

WECC's General Counsel informed the Audit staff that WECC had taken bids from companies that would operate a hotline to provide WECC compliance staff members a means to report any contact they believe is inappropriate. WECC's General Counsel also indicated that WECC's Governance and Nominating Committee (GNC) had discussed these issues in its April 2009 meeting. The GNC meeting minutes indicate that WECC's General Counsel thought WECC should "push back" on any requests for a member of the Board to participate in the settlement process. Further, the meeting minutes indicate that if a registered entity were to insist on the participation of a director in the negotiations, WECC would consider whether the Director was:

- A chair or vice chair of the Board or a committee;
- A member of an influential committee;
- A participant in routine reliability related job duties; and
- Involved in the audit process.

If, based on the above criteria, WECC determines there is an appearance of impropriety, WECC has discussed raising the issue to the entire Board of Directors for final determination.

As indicated in the meeting minutes of the July 2009 GNC meeting, WECC's General Counsel and Managing Director, Human Resources and Administration were developing a proposal to address the issue of inappropriate communications to be presented to the Board of Directors at the October 2009 meeting; however, WECC staff was not able to develop a proposal. A comprehensive proposal is slated to be presented at the April 2010 meeting of the Board of Directors, if not sooner.

On July 22, 2009, WECC entered into an agreement with a hotline vendor. The hotline is nearly ready to be rolled out. The hotline has been developed to provide staff a confidential way to voice concerns relating to the following situations:

- Fraudulent or negligent accounting;
- False financial reporting;
- Violation of the WECC Delegation Agreement;
- Conflicts of Interest;
- Breaches of confidentiality;
- Violations of antitrust laws;
- Violations of reliability standards by WECC;
- Inappropriate gifts or gratuities;
- Bribes or kickbacks;
- Harassment or discrimination; and
- Safety or security hazards.

### **Recommendation**

We recommend that WECC:

14. Develop and implement a procedure for WECC employees to follow if they believe they have been inappropriately contacted by any member of WECC that would apply unless, and until, WECC oversight of the CMEP process is conducted by non-affiliated parties;
15. Implement a formal plan to avoid undue influence on WECC compliance staff when a WECC Board member is a participant in an action, or, in the alternative;

16. Enforce a mandatory recusal process from all compliance actions for affiliated Board members who would otherwise participate in CMEP actions involving their employers; and
17. Present the plans and processes to avoid actual or perceived conflict of interests to the Commission Audit staff for its review.

## Attachment B



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April 20, 2010

Bryan K. Craig  
Director and Chief Accountant, Division of Audits  
Office of Enforcement  
Federal Energy Regulatory Commission  
888 First Street NE – Room 51-37  
Washington, D.C. 20426

Re: Western Electricity Coordinating Council  
Docket No. PA09-5-000

Dear Mr. Craig:

Western Electricity Coordinating Council ("WECC") provides the following response to the April 9, 2010 Revised Draft Audit Report ("Draft Audit Report") of the Division of Audits of the Federal Energy Regulatory Commission's ("FERC" or "Commission") Office of Enforcement ("Audit Staff") related to WECC's function as a Regional Entity ("RE").

#### **I. SUMMARY OF WECC'S RESPONSE**

WECC has reviewed the Draft Audit Report and has carefully considered its recommendations. WECC generally agrees with several of the recommendations and is undertaking certain measures that should alleviate many of the concerns outlined in the Draft Audit Report. These measures are described below. As is also discussed below, WECC disagrees with many of the findings and questions the extent of the Commission's jurisdiction regarding recommendations directing modifications to WECC's internal corporate governance. WECC will explain the basis for these disagreements in this response.

##### **A. WECC is undertaking measures that should alleviate many of the concerns outlined in the Draft Audit Report.**

The Draft Audit report raises a number of concerns regarding: WECC's accounting for certain activities; WECC's Western Interchange Tool, including WECC's subsequent registration as an Interchange Authority in the Western Interconnection; a WECC Board Committee; WECC's compliance enforcement process backlog; and concerns over the possibility of inappropriate communications regarding compliance activities. WECC has filed a revised 2010 Business Plan and Budget with the North American Electric Reliability Corporation ("NERC"), which will be filed with the Commission. In the revised 2010 Business Plan and Budget, WECC proposes an accounting treatment for the United States Department of Energy ("DOE") grant awards and a revised indirect cost allocation, and seeks formal approval of the WECC Interchange Tool

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Mr. Bryan K. Craig  
April 19, 2010  
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("WIT") and the Western Interconnection Synchrophasor Program ("WISP") as situational awareness and infrastructure security activities. WECC submitted a revised Exhibit E to the Delegation Agreement specifically listing the WIT and WISP as statutory functions under "situational awareness." With these comments, WECC seeks the Commission's consideration of several of the issues identified in the Draft Audit Report. WECC will propose actions in response to other recommendations in its implementation plan.

**B. WECC disagrees with certain findings and is concerned with certain recommendations in the Draft Audit Report.**

Notwithstanding the measures that WECC is undertaking as described above, WECC disagrees with many of the findings included in the Draft Audit Report. WECC has identified several such aspects of the findings in detail below. WECC concurs with most of the recommendations, but maintains some concerns regarding the scope of particular recommendations.

**II. ORGANIZATIONAL STRUCTURE**

Before addressing the detailed findings and recommendations of the Draft Audit Report, WECC seeks to clarify certain aspects of the organizational structure of WECC as set forth in Section D of the Draft Audit Report.<sup>1</sup> First, WECC's thirty-two Directors include seven Non-Affiliated Directors, four Directors elected from the Canadian Member Class, four Directors elected from the state and provincial Member Class, four Directors from the end users Member Class, four Directors from the Electric Line of Business Member Class (e.g. power marketers, independent power producers, load serving entities, and other entities providing energy services), four Directors from the small transmission and distribution providers Member Class, four Directors from the large transmission and distribution providers Member Class, and one Mexican Director. Consequently, only 12 of the 32 Directors come from Member Classes whose members could potentially be considered users, owners, or operators of the Bulk Power System of such a size as to mandate registration and compliance with reliability standards adopted under the authority of FPA Section 215.

WECC's governance structure meets the requirements for a Regional Entity. In 2007, the Commission found that WECC's governance structure satisfied the governance requirements of FPA Section 215 and the NERC *pro forma* Exhibit B governance criteria.<sup>2</sup> The Commission specifically found that WECC's Board "will be independent because it will be comprised of directors chosen from all industry segments, with no two sectors able to control a vote."<sup>3</sup> While the WECC Board meets formally four times a year, the Board may take action via special meetings (which can be by conference call) and by written unanimous consent.

As indicated in the Draft Audit Report, WECC has member committees to advise and make recommendations to the Board.<sup>4</sup> The member committees include three Standing Committees coordinating reliable operations, planning, and compatible commercial practices. The Board

<sup>1</sup> Draft Audit Report at 5.

<sup>2</sup> North American Electric Reliability Corporation, et al., *Order Accepting ERO Compliance Filing, Accepting ERO/Regional Entity Delegation Agreements, and Accepting Regional Entity 2007 Business Plans*, 119 FERC ¶61,060 at ¶452 (April 19, 2007).

<sup>3</sup> *Id.*

<sup>4</sup> WECC Bylaws §8.

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may also create other member committees.<sup>5</sup> Actions by the member committees are in the form of a recommendation for Board action, unless the Board has specifically delegated to a committee the power to take action subject to an appeal to the Board by any Member.<sup>6</sup>

The WECC Bylaws also allow for Board level committees to address WECC's business matters. The WECC Bylaws specifically call for a Governance and Nominating Committee of the Board to propose slates of candidates for Board Director positions, oversee the Bylaws, and address other governance issues.<sup>7</sup> The Board may also create other Board committees to carry out business affairs.<sup>8</sup> All members of any Board committee must comply with WECC's Standards of Conduct applicable to Board Directors.<sup>9</sup>

Furthermore, the Commission determined that WECC's voting and quorum protocols met the governance requirements of FPA section 215 and the *pro forma* Exhibit B governance criteria for committee decision-making and organization structure.<sup>10</sup> Criterion 4 of the *pro forma* Exhibit B governance criteria specifically states that a "Regional Entity has established rules that assure balance in its decision-making committees and subordinate organizational structures and assure no two industry sectors can control any action and no one industry sector can veto any action."<sup>11</sup>

All together, WECC has three member committees (the Standing Committees) with numerous subcommittees, a committee to coordinate the activities of the Standing Committees, and eight Board committees (including the Governance and Nominating Committee mandated by the WECC Bylaws). WECC's complex structure and long history reflects its unique position as an interconnection-wide Regional Entity, with a footprint including parts of 14 states, two Canadian provinces, and part of Mexico. WECC's position, and lack of any alternative organization to coordinate reliability across the entire region, adds to the complexity of the organization.<sup>12</sup>

### III. WECC'S RESPONSE TO DRAFT AUDIT REPORT FINDINGS AND RECOMMENDATIONS

WECC offers the following specific responses to the findings and recommendations articulated in the Draft Audit Report. Further, WECC reserves the right, following the issuance of the Audit Report, to seek review with respect to each contested matter.<sup>13</sup>

<sup>5</sup> WECC Bylaws §8.3.

<sup>6</sup> WECC Bylaws §8.5.1.

<sup>7</sup> WECC Bylaws §7.7.1.

<sup>8</sup> WECC Bylaws §7.7.2.

<sup>9</sup> WECC Bylaws §7.7.3.

<sup>10</sup> 119 FERC ¶¶61,060 at ¶ 452.

<sup>11</sup> *Amended and Restated Delegation Agreement between the North American Electric Reliability Corporation and Western Electricity Coordinating Council* ("Delegation Agreement"), Exhibit B (referencing requirements in FPA § 215(c)(2)(D) and (e)(4), and 18 C.F.R. §39.8(c)(2)).

<sup>12</sup> North American Electric Reliability Corporation, 119 FERC ¶¶61,059 at ¶¶18 (April 19, 2007)

<sup>13</sup> The procedural context of, and source of authority for, the Draft Audit Report is unclear. The November 13, 2008 Audit Commencement Letter from Susan J. Court to Matthew McVee stated that "[t]his audit is being conducted pursuant to section 301 of the Federal Power Act, 16 U.S.C. § 825." Section 825 provides in part that "[e]very licensee and public utility shall ... preserve ... accounts" that FERC has "the right to ... examine all accounts" and that "licensees and public utilities [shall] furnish to the Commission ... any information ... which the Commission by order may require ... [and] grant to agents of the

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**A. WECC accounted for statutory and non-statutory activities and coordinated with NERC, following currently applicable processes for a Regional Entity acting pursuant to a Delegation Agreement with the ERO**

Contrary to the statements in the Draft Audit Report, WECC adequately segregated monies in its books and records received for statutory and non-statutory functions.<sup>14</sup> WECC's accounting system accurately tracked the program costs for statutory and non-statutory activities, allocating overhead to both. The findings in the Draft Audit Report are not based on any "inaccuracy" in WECC's accounting. Rather, the findings and recommendations indicate a concern on the part of Audit staff that certain WECC activities were non-statutory. This is an area in which FERC has directed NERC to provide more guidance.<sup>15</sup>

WECC disagrees with the Audit Staff's concerns as to whether WECC properly identified and funded activities that it performs on behalf of members and that go beyond the activities that the Commission has approved for statutory funding.<sup>16</sup> The Audit Staff specifically cites to WECC's performance of the Interchange Authority ("IA") function and states that its concerns were exacerbated by other member funded activities.<sup>17</sup> Yet WECC identified the WIT costs and the activities with which it is associated.<sup>18</sup>

While WECC disagrees with many aspects of the findings in the Draft Audit Report, the recommendations within this section of the Draft Audit Report are acceptable. WECC has not yet executed all of the DOE grant agreements and has revised its 2010 Business Plan and Budget to incorporate the proposed expansion to currently approved programs. WECC has included revisions to standardize the treatment of indirect costs across statutory and non-statutory functions and clarify the status of the WIT, the basis for WECC's registration as the Interchange Authority. WECC will segregate costs of performing the Interchange Authority ("IA") function from other 215 functions until FERC has an opportunity to review and approve the function as statutory. As part of the revised 2010 Business Plan and Budget filing, WECC requested a revision to Exhibit E of the Delegation Agreement to clarify the status of the WIT and WISP activities. WECC will work with NERC and Audit Staff to outline activities and develop procedures to properly classify and track activities and assign costs. WECC accepts the recommendations related to accounting matters because it believes that they will enhance WECC's operations.

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Commission free access to ... its accounts." 16 U.S.C. § 825(a), (b). WECC is not a licensee, 16 U.S.C. § 796(5), and is also not a public utility with respect to its Section 215 activities ("any person who owns or operates facilities subject to the jurisdiction of the Commission"). In addition, although the Commission's regulations provide that it may audit the Electric Reliability Organization's performance of its Section 215 obligations, the Commission chose not to extend this audit function to regional entities. 18 C.F.R. § 39.9(b); *Rules Concerning Certification of the Electric Reliability Organization, and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, 114 FERC ¶61,104 at ¶ 773 (2006) (the "Final Rule eliminates the proposed periodic Commission audit of each Regional Entity. Instead, we require the ERO periodically to audit each Regional Entity's ongoing compliance").

<sup>14</sup> Draft Audit Report at 15.

<sup>15</sup> North American Electric Reliability Corporation, 17 FERC ¶61,091 at 39.

<sup>16</sup> Draft Audit Report at 16.

<sup>17</sup> *Id.* at 15-16.

<sup>18</sup> See 2008 Business Plan and Budget at 3, 14, 24; 2009 Business Plan and Budget at 42, 44; 2010 Business Plan and Budget at 16.

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(i) Pertinent Guidance

The Draft Audit Report does not identify the applicable standards for evaluating WECC's accounting practices. The Draft Audit Report cites to WECC's initial proposal to spread the costs of non-statutory activities to both participating members and members that benefit from a non-statutory program.<sup>19</sup> FERC rejected WECC's proposal, limiting any assessment for non-statutory activities to those entities participating in the activity.<sup>20</sup> The Draft Audit Report then cites Exhibit E of the Delegation Agreement, and WECC's obligation to identify in its annual Business Plan and Budget any non-statutory activity.

The description of pertinent guidance in the Draft Audit Report does not identify a compliance standard for evaluating WECC's accounting system. Instead, the Draft Audit Report's statement of pertinent guidance merely cites to WECC's proposed funding mechanism for non-statutory activities and the Delegation Agreement. The description of pertinent guidance suggests well-established and detailed guidelines exist upon which a Regional Entity can base its analysis of whether an activity is statutory or non-statutory. In actuality, the process is still in its infancy and Regional Entities must look to FERC's prior approval of the ERO and Regional Entities' Business Plans and Budgets.

The annual Business Plan and Budget filing is the mechanism by which the ERO and Regional Entities seek Commission approval of all statutory activities to be funded under Section 215, and disclosure of any non-statutory activities to ensure the independence of Regional Entities from users, owners, and operators of the Bulk Power System.<sup>21</sup> In Order 672, the Commission stated that the complete business plan and the entire budget "will provide the Commission with necessary information about any non-statutory activities, the source of their funding, and whether the pursuit of such activities presents a conflict of interest for the Regional Entity."<sup>22</sup>

(ii) Findings

(a) Federal Grant Monies

WECC submits that the Draft Audit Report's findings that WECC must assure proper accounting treatment for the future grant monies received is premature.<sup>23</sup> WECC has not received any grant monies and has only recently executed its first grant agreement and submitted an amended 2010 Business Plan and Budget for NERC approval and filing with the Commission. WECC has been in discussions with NERC regarding treatment of all DOE grant awards and the mechanism for notification to the Commission.

(b) WECC Budget Treatment of the Interchange Authority Activities

The WIT is a system to facilitate and coordinate interchange between WECC Balancing Authorities that provides additional functionality beyond the activities contemplated under the

<sup>19</sup> Draft Audit Report at 15-16.

<sup>20</sup> *Id.* at 15.

<sup>21</sup> Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards, 114 FERC ¶61,104 (2006) ("Order 672") at 228, order on rehearing 114 FERC ¶ 61,328 ("Order 672-A") at ¶60.

<sup>22</sup> *Id.*

<sup>23</sup> Draft Audit Report at 17.

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Interchange Authority function. The WIT provides interchange scheduling information to the Reliability Coordinators and eliminates the possibility of Balancing Authorities controlling to different Net Scheduled Interchange values, resulting in reduced primary inadvertent interchange. Prior to the implementation of the WIT, each Balancing Authority calculated Net Scheduled Interchange with its adjacent Balancing Authorities. As the calculations were conducted independently, the Balancing Authorities were forced to use inefficient methods to ensure coordinated interchange. There was no single source of Net Scheduled Interchange approved by all parties. The WIT provided that single source of interchange information, the record of implementation, and the record of approval by parties to the transaction.

The WIT provides substantial benefits to both the reliability of individual WECC Members and the Western Interconnection as a whole. The Commission has recognized the benefit of such "member service functions," and has approved funding of such services, generally, under section 215.

[T]hese services are extremely useful for the provision of adequate reliability, because they relate specifically to compliance with existing standards and they proactively help avert Reliability Standard violations and system disturbances. At this time, in the absence of an independent organization stepping forward to provide some of these services as with the example of INPO in the nuclear industry, adequate reliability on the Bulk Power System is better assured if the ERO offers to provide them.<sup>24</sup>

NERC's filing of the WECC Reliability Coordinator and WIT was consistent with this policy.

The Draft Audit Report appears to assume that previously funded activities no longer qualify if compliance registration is required. WECC's correspondence with NERC outlines the intense discussion regarding this registration.<sup>25</sup> WECC and NERC also included the Interchange Authority in the Compliance Enforcement Authority Agreement ("CEA Agreement") identifying NERC as the Compliance Enforcement Authority over WECC's registered functions.<sup>26</sup> The Commission approved the CEA Agreement on February 17, 2009.<sup>27</sup>

Following discussions with the Audit staff, WECC acknowledges the policy impacts associated with the registration asserted in the Draft Audit Report, but submits that the CEA Agreement appropriately addresses conflict-related issues concerning Regional Entity performance of registered functions.

(c) WREGIS Accounting Issues

The Draft Audit Report's allegations of inaccurate accounting practices also included concerns regarding the process by which WECC accounts for resources dedicated to non-statutory functions. Audit staff, after reviewing the accounting treatment for WREGIS, found that WECC's current accounting methodology for WREGIS, based upon rough estimates, could be refined

<sup>24</sup> North American Electric Reliability Corporation, 116 FERC ¶61,062 at ¶188 (2006).

<sup>25</sup> Draft Audit Report at 23-24.

<sup>26</sup> , *Further Status Report of the North American Electric Reliability Corporation and Western Electricity Coordinating Council in Response to Paragraph 226 of March 21, 2008 Commission Order*, filed in Docket No. RR07-7-006, (November 21, 2008).

<sup>27</sup> NERC, Docket Nos. RR06-1-018 and RR07-7-006, Letter Order issued February 17, 2009, at ¶6.

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without significant costs. While WECC welcomes recommendations that would improve its processes, it disagrees with the findings in the Draft Audit Report in one respect.

The Draft Audit Report states that prior to the commencement of the audit, WECC did not have an accounting system that could be utilized for reviewing overhead costs for allocation between WECC statutory and WREGIS activities. This is only partially correct. WECC's accounting system could not inherently track the cost allocation. Instead, such tracking would have been addressed in WECC's manual payroll system.

WECC does not oppose further development of policies and procedures to ensure that the section 215 funding mechanism does not include any non-statutory activities. Consequently, WECC accepts those recommendations identified in this section of the Draft Audit Report that would further improve the WECC accounting system.

(iii) Recommendations

Notwithstanding WECC's disagreement with the Draft Audit Report's findings, WECC does not take issue with the proposed recommendations as they will likely improve its operations.

**Recommendation 1:** Identify how WECC intends to segregate grant money received for statutorily funded tasks being performed by WECC and funded under section 215.

WECC concurs with this recommendation. WECC has been in discussions with NERC staff and NERC Finance and Audit Committee regarding accounting treatment for the DOE grants for several months. WECC has revised its 2010 Business Plan and Budget and has submitted it to NERC for review and approval. WECC will provide any assistance necessary to NERC to effectuate its filing of the revisions to FERC.

**Recommendation 2:** Segregate the costs of performing the Interchange Authority function from section 215 funding unless and until FERC has approved these costs for section 215 recovery.

WECC concurs with this recommendation. WECC acknowledges Audit staff's concern that the Commission should have an opportunity to fully consider whether a Regional Entity's costs associated with the IA function should be funded under Section 215. Segregation of costs until the Commission has the opportunity to evaluate the specific facts and WECC's proposed inclusion of the activity is an acceptable recommendation.

**Recommendation 3:** Provide a detailed list of all activities performed by WECC that are not specifically included as statutory or non-statutory activities in the Delegation Agreement Exhibit E, including details of any expansion of previously approved functions.

WECC will work with FERC and NERC to identify its activities. WECC's goal will be to clarify criteria by which Regional Entities can assess whether a program qualifies for statutory funding. This is critical given the type of activities conducted by organizations such as WECC, particularly considering that NERC, and most Regional Entities, have committees designed to coordinate operations between industry participants.

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**Recommendation 4:** Revise its existing accounting system to properly classify and track statutory and non-statutory activities and funding for these activities.

WECC concurs with this recommendation. This recommendation, coupled with additional guidance on the types of activities that may qualify for funding under the ERO and clarification as to the process for Commission approval, will enhance WECC activities as a Regional Entity. WECC, however, believes that the issue relates more to the development of procedures in response to guidance from FERC and NERC on which activities may or may not qualify for funding as ERO activities, rather than any change to the accounting software or practices.

**Recommendation 5:** Adopt commonly accepted policies and procedures used to track actual expenditures for shared service costs, overhead costs, WECC RE staff hours, and associated costs for statutory and non-statutory functions.

WECC concurs with this recommendation. WECC will update its process to distribute indirect costs across all activities. WECC has proposed a revised allocation methodology for indirect costs in the revised 2010 Business Plan and Budget incorporating the DOE grant awards. The revised 2010 Business Plan and Budget will be filed with the Commission following NERC Board of Trustees approval.

**B. WECC accepts the recommendation that it revise its Exhibit E to the Delegation Agreement to include the WECC Interchange Tool**

**(i) Findings**

While the WIT was specifically addressed in WECC's previous Business Plan and Budget filings, WECC acknowledges the concerns of Audit staff regarding the need to specifically request the inclusion of any registered function in Exhibit E to the Delegation Agreement.

WECC believes the WIT provides significant reliability benefits beyond the Interchange Authority function, and should be treated as an ERO service. While the background discussion in the Draft Audit Report is accurate to the extent that it discusses the dispute between WECC and NERC regarding registration of an Interchange Authority in the Western Interconnection, the following context is also important.

On July 26, 2006, WECC's Board of Directors approved the business case for the WIT. As discussed above, the WIT provides a system to facilitate and coordinate interchange between WECC Balancing Authorities and provide interchange scheduling information to the Reliability Coordinators. The WIT eliminates the possibility of Balancing Authorities controlling to different Net Scheduled Interchange values, resulting in reduced primary inadvertent interchange. Prior to the implementation of the WIT, each Balancing Authority calculated Net Scheduled Interchange with its adjacent Balancing Authorities. As the calculations were conducted independently, the Balancing Authorities were forced to use inefficient methods to ensure coordinated interchange. There was no single source of Net Scheduled Interchange approved by all parties. WIT provided that single source of interchange information, the record of implementation, and the record of approval by parties to the transaction.

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WECC executed a contract with OATI to develop the WIT after the Board's approval of the business case. WECC put the WIT in its first Regional Entity Business Plan and Budget, submitted to NERC. At the time, the Commission found NERC's first filing of the Business Plans and Budgets to lack sufficient detail.<sup>28</sup> Subsequent WECC Budgets included additional descriptions of the WIT.

WECC developed the WIT to increase coordination before the implementation of mandatory reliability standards, whereby WECC, as an independent organization, held the contract with the software vendor. The software service provided by that vendor provides, among other things, those services identified in the reliability standards applicable to the Interchange Authority. However, the Interchange Authority, under the applicable standards, does nothing more than confirm all of the required information is included in an electronic tag request for transmission service, distribute the tag to applicable Balancing Authorities, and communicate to the entity submitting the tag whether all affected Balancing Authorities either approve or reject the tag. All of these functions are completed within 60 seconds for each tag. There is no way that this function can be performed without automation, and it is questionable whether the Interchange Authority function is a function of a "user, owner, or operator of the Bulk Power System" within the Western Interconnection.

WECC coordinated with NERC on its Business Plans and Budgets and expressly included the WIT in those documents, which were subsequently filed and approved by the Commission. The subsequent registration of WECC as the Interchange Authority should not automatically disrupt the funding of a tool that provides significant benefits to reliability. The Commission has stated that the provision of certain tools and support services to the industry "are extremely useful for the provision of adequate reliability and proactively help avert Reliability Standard violations and system disturbances."<sup>29</sup> The WIT is such a service and the issue of registration of the Interchange Authority in the Western Interconnection relates only to the appropriate organization(s) to register in order to ensure compliance with the applicable Reliability Standards, not the significant reliability benefits of the WIT.

(ii) Recommendation

**Recommendation 6:** Submit a revised Exhibit E of the NERC-WECC RDA to the Commission requesting a review of whether WECC's performance of the IA Function is a statutory function.

WECC concurs with the recommendation that it seek to revise Exhibit E to the Delegation Agreement to specifically include the WIT. WECC has addressed this issue in its revisions to the 2010 Business Plan and Budget and a proposed revision to Exhibit E of the Delegation Agreement.

**C. Board level committees dedicated to the evaluation of performance and policy issues of a key Regional Entity role under the Delegation Agreement with NERC should be encouraged, consistent with appropriate conflict of interest and confidentiality safeguards**

WECC disagrees with the Draft Audit Report findings regarding the WECC Compliance Committee ("WCC"), but accepts the recommendations as a way to strengthen WECC's internal

<sup>28</sup> North American Electric Reliability Corporation, et al, 119 FERC ¶61,060 at ¶596-598.

<sup>29</sup> North American Electric Reliability Corporation, 116 FERC ¶61,062 at ¶188.

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controls. WECC believes the conclusions in the Draft Audit Report are at odds with the Commission's previous findings that Regional Entity governance should be left sufficiently open, consistent with the statute, to allow flexibility for Regional Entities to find a governance structure appropriate to their region and the corporate bylaws, which provide the necessary assurance of balanced representation and independence from users, owners, and operators of the Bulk Power System.<sup>30</sup> Contrary to the conclusion of the Draft Report,<sup>31</sup> moreover, the WECC Standards of Conduct specifically require recusal in the event of a conflict of interest.<sup>32</sup>

(i) Pertinent Guidance

Section 215(e)(4) of the Federal Power Act allows a Regional Entity to be governed by "(i) an independent board; (ii) a balanced stakeholder board; or (iii) a combination independent and balanced stakeholder."<sup>33</sup> Section 403 of the NERC Rules of Procedure ("ROP") does not modify the fundamental governance provision of Section 215. Section 403.1 of the NERC ROP merely states that a Regional Entity must organize its compliance monitoring and enforcement activities separately from other activities of the Regional Entity.<sup>34</sup> The requirement that the program not be unduly influenced by system owners, operators, and users must be applied to members of WECC's Board of Directors in a manner consistent with Section 215(e)(4).

Similarly, Section 403.6.2 of the NERC ROP does not limit corporate governance. Section 403.6.2 simply requires that a Regional Entity's compliance enforcement program staff has the authority to investigate, audit, make initial determinations of compliance, and levy penalties without interference or undue influence from members and their representatives. The WECC Board of Directors and the WCC do not act as representatives of the members. Each Director owes a specific fiduciary duty to the corporation, and is required to act in the best interests of WECC at all times.<sup>35</sup>

WECC Bylaw Section 6.12 merely delegates governance authority to a subset of the Board, which does not violate any of the identified requirements. The oversight provided by the WCC does not interfere with the organizational separation of the compliance enforcement program. Nor does the WCC provide an avenue for interference or undue influence by WECC Members or industry entities, due to the express duties of care and loyalty applicable to board members, including the prohibitions against undue influence, misuse of confidential information and avoidance of conflicts of interest.<sup>36</sup> Directors on the WECC Board are responsible for the operation of the corporation, including compliance with applicable agreements and regulations,

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<sup>30</sup> *Id.* at ¶544.

<sup>31</sup> Draft Audit Report at 31-32.

<sup>32</sup> WECC Bylaws, Appendix A at Sections II(C), II(E)(4)(c).

<sup>33</sup> 16 U.S.C. § 824o(e)(4).

<sup>34</sup> Presumably this would include activities such as Reliability Standard Development, Organization Certification, Reliability Readiness Evaluation and Improvement, Reliability Assessment and Performance Analysis, Training and Education, Situational Awareness and Infrastructure Security, and non-statutory programs.

<sup>35</sup> WECC Bylaws Appendix A: Standards of Conduct for Members of the WECC Board of Directors at Section II ("The duty of loyalty imposes on a Director the obligation to remain loyal to the WECC, acting at all times in the best interests of WECC...").

<sup>36</sup> WECC Bylaws, Appendix A.

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and any further restrictions on a Board's ability to monitor compliance would potentially undermine fundamental aspects of corporate governance.<sup>37</sup>

(ii) Findings

The Draft Audit Report raises concerns over possible future risks to the independence of WECC Compliance Monitoring and Enforcement Program ("CMEP") activities. These concerns appear to suggest an antagonism toward a hybrid Board of Directors, contrary to section 215 of the Federal Power Act, and a preference for limiting Board insight into the key role of WECC as a Regional Entity. Those views are at odds with federal law and the Commission's prior approval of the WECC governance structure.<sup>38</sup>

WECC is allowed to have a hybrid Board of Directors, with both affiliated and non-affiliated Directors.<sup>39</sup> WECC's Board, as discussed above, includes Directors elected by six member classes, seven non-affiliated Directors and one Director selected by WECC's Mexican delegation. All Board Directors are bound by Standards of Conduct, which prohibit the use of their position for the benefit of themselves or affiliated organizations.<sup>40</sup> As Directors for the corporation, WECC's Board is ultimately responsible for compliance with the Delegation Agreement and FERC policy.

The WCC provides a forum for WECC CMEP staff to discuss current program status, resourcing issues, and brief the Board on policy issues regarding the CMEP. The WCC was created in response to the early backlog of violations in process as a way to provide more information to the Board in light of potentially significant issues being raised by both NERC and industry participants. Due to the sensitive nature of compliance activities, the WCC was created to provide a small group of Board Directors with additional insight and education in the issues faced by WECC's CMEP. The WCC Charter specifically states that the WCC does not interfere with the day to day operations of the WECC CMEP.<sup>41</sup> In this way, the WCC is no different than a Board Audit Committee or an internal compliance program, where the goal is compliance with critical operations and regulations. In fact, the Draft Audit Report acknowledges the benefits of the WCC.<sup>42</sup>

Several of the Draft Audit Report's findings require response. First, while the WCC Charter outlines a recommended mix of Board Director representation on the Committee<sup>43</sup>, that recommendation is secondary to a requirement that a majority of the members be from non-Electric Line of Business Member Classes.<sup>44</sup> The Draft Audit Report states that this representation is merely a guideline. While the statement in the Draft Audit Report is true, with

<sup>37</sup> *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 403-04 (2004) ("CAISO v. FERC").

<sup>38</sup> *Id.* at 404.

<sup>39</sup> 16 U.S.C. § 824o(e)(4).

<sup>40</sup> WECC Bylaws Appendix A.

<sup>41</sup> WCC Charter p. 1.

<sup>42</sup> Draft Audit Report at 34.

<sup>43</sup> Draft Audit Report at 28.

<sup>44</sup> WCC Charter p. 2; WECC Compliance Hearing Body Charter p. 2 ("The CHB shall be an open committee consisting of two classes of members: **Class A:** WECC non-affiliated directors, personnel employed by WECC Members who are not engaged in the Electric Line of Business, and consultants who meet the same standards of independence required by the WECC Bylaws for non-affiliated directors, and **Class B:** Personnel employed by WECC Members engaged in the Electric Line of Business or who are otherwise affiliated with such Members.").

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respect to the recommended composition of the Committee, there are additional protections within the WCC Charter which should negate concerns over Directors that work for Registered Entities controlling a vote of the WCC.

The WCC was modeled after the WECC Compliance Hearing Body. That structure addresses both membership and quorum requirements. The WECC Compliance Hearing Body classifies its members into two classes (Class A and Class B). Class A includes individuals from the following industry segments: end-users, state and provincial representatives, Canadian Members, and Non-Affiliated Directors. Class B includes individuals from Electric Line of Business entities.<sup>45</sup> A majority of the Compliance Hearing Body must come from Class A. Additionally, action may not be taken without a majority of voting members being from Class A. The latter establishes a quorum requirement that ensures the independent action of the Compliance Hearing Body. The WCC is structured the same as the Compliance Hearing Body.

The Commission has already found that the structure of WECC Compliance Hearing Body meets the independence requirement in section 403.<sup>46</sup> Furthermore, the WCC is a Board Committee, having only Board Directors as members of the Committee. Member representatives are not part of the WCC, and, as discussed above, each Board Director has a fiduciary responsibility to act in the best interests of the corporation.<sup>47 48</sup>

The Draft Audit Report references open discussions during a WECC committee meeting as evidence of Registered Entities' "desire for direct involvement in the CMEP process."<sup>49</sup> While WECC acknowledges that some Registered Entities not previously subject to Commission regulation may still have concerns with the new oversight, the WCC did not create a new stakeholder committee, nor did it attempt to micromanage the day to day operations of WECC

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<sup>45</sup> Electric Line of Business entities are WECC Members from Member Classes 1 through 3, and could be subject to compliance with the Commission-approved mandatory Reliability Standards. WECC Members from Member Classes 4 through 7, represent end-users, state and provincial representatives, Canadian Members, and interested stakeholders.

<sup>46</sup> North American Electric Reliability Corporation, et al, 122 FERC ¶61,245 at ¶235 (2009).

<sup>47</sup> "Directors and officers have a fiduciary duty of loyalty to their corporation and its stockholders. They are obligated to use their ingenuity, influence, and energy, and to employ all the resources of the corporation, to preserve and enhance the property and earning power of the corporation, even if the interests of the corporation are in conflict with their own personal interests. This duty extends to all of the corporation's assets, including its subsidiary corporations." *Nicholson v. Evans*, 642 P.2d 727, 729 (Utah 1982)(internal citations omitted).

<sup>48</sup> The duty of the directors of a corporation is to further the interests and business of the association and to conserve its property. Any action on the part of directors looking to the impairment of corporate rights, the sacrifice of corporate interests, the retardation of the objects of the corporation, and more especially the destruction of the corporation itself, will be regarded as a flagrant breach of trust on the part of the directors engaged therein. 2 *Thompson on Corporations*, 1327.

<sup>49</sup> *Id.*

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staff.<sup>50</sup> WECC Board Directors are not member representatives from Registered Entities and it is the WECC Board that is ultimately responsible for compliance with the Delegation Agreement.

The Draft Audit Report includes incomplete discussions of interviews with a small number of WECC Board Directors. The Draft Audit Report includes paraphrased excerpts from Audit Staff's unrecorded discussions with certain WECC Board Members.<sup>51</sup> While several Directors discussed complaints they heard during the initial implementation of the compliance enforcement program, the full discussion of the particular motivation behind the Directors' votes was more complete and related to their duty of care in the governance of the organization.<sup>52</sup> In the end, however, it is not the justification behind an individual Director's vote to create the WCC that should be at issue, but rather the implementation of the WCC in compliance with applicable requirements. The WCC charter was drafted after considering the Commission's guidance and corporate responsibilities.<sup>53</sup>

Finally, WECC disagrees with the Draft Audit Report's statement that there is no provision in the WCC Charter identifying the required action where there is a conflict of interest. The WCC charter specifically references compliance with the WECC Standards of Conduct for Members of the WECC Board of Directors.<sup>54</sup> While the charter allows the chair to dismiss a member with a conflict of interest from a meeting, the WECC Standards of Conduct for Board Directors mandates disclosure and recusal when a personal or organizational conflict of interest arises.<sup>55</sup>

WECC agrees with the finding that the language of the WCC Charter regarding treatment of confidential information should be clarified. Members of the WCC may need limited access to confidential information in order to understand the full scope of issues facing WECC's compliance enforcement program, or to discuss relevant influences on a particular activity. Confidential information, however, does not necessarily mean information relative to a particular entity, but includes confidential NERC directives on enforcement priorities and procedures. Many developing issues, audit techniques, and procedural directives from NERC are

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<sup>50</sup> The WCC Charter does not include a delegation of authority to the committee. While the Board is allowed to delegate authority to committees under section 6.12 of the Bylaws, such a delegation would be explicit and was disclosed to Audit staff during the on-site visit and in WECC's response to Data Request 64 (contrary to the assertion on page 31 of the Draft Audit Report regarding the WECC General Counsel). This finding raises concerns over the use of interview notes as a basis for some of the findings (evidence created by the Audit staff) in the Draft Audit Report.

<sup>51</sup> Board Directors interviewed during the June 2009 on site visit by Audit Staff included two Non-Affiliated Directors and two Directors from the state and provincial Member Class.

<sup>52</sup> WECC, as with NERC and the other Regional Entities, still has an industry membership. WECC, its Board, and its staff, cannot prohibit Member organizations from taken positions contrary to WECC. Complaints from Registered Entities regarding a new form of regulation do not "illustrate a significant desire by members to limit the ability of the WECC RE from exercising a strongly independent CMEP program." Complaints could come from frustration with new regulations, the lack of clarity in the Reliability Standards, or the delays due to WECC's violation processing backlog. WECC's Board of Directors should not be required to ignore industry comments to meet the requirement of independence.

<sup>53</sup> WECC Response to Data Request 52.

<sup>54</sup> WCC charter p. 3 (Membership item i).

<sup>55</sup> WECC Bylaws Appendix A Sections IIE(3)(b) and IIE(4)(c). Similar to typical nonprofit business corporation statutes, the Standards of Conduct require the director to disclose the conflicting interest and refrain from voting, but do not prohibit the director's presence at the meeting. *E.g.* Utah Code § 16-6a-825(4).

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confidential, especially during development. The WCC provides a forum to discuss policy positions and resourcing requirements with a small group of Board Directors. This is key given the timing of new initiatives from NERC may not always coincide with the ERO budget cycle.<sup>56</sup>

Information regarding a particular Registered Entity may also need to be disclosed, with appropriate safeguards, to help the WCC understand particular risks facing the corporation.<sup>57</sup> Procedures to address this type of data are under development. The Draft Audit Report correctly identifies that, as a new committee, the WCC will need to address these issues as they arise, but this is no different than any other corporate issue for which the Board of Directors is ultimately responsible.

(iii) Recommendations

While WECC views its ability to establish Board committees as essential to its governance, WECC also believes it can address the concerns raised by Audit staff regarding confidentiality and additional protections to address independence from Registered Entities. WECC sees the recommendations as helpful to the extent that they work to improve WECC as a Regional Entity. Therefore, WECC agrees to the recommendations in the Draft Audit Report as discussed below.

**Recommendation 7:** Revise the WCC charter to ensure independence of the CMEP function.

WECC concurs with this recommendation to the extent that it only requires WECC to clarify that the WCC will be populated by Board Directors and will work with Audit staff to identify any potential gaps in the charter that could allow Registered Entities to unduly influence the compliance enforcement process.

**Recommendation 8:** Revise the WCC charter to ensure the confidentiality of CMEP data.

WECC concurs with this recommendation. While confidential information may need to be discussed with the WCC to fully inform the subset of Board members, additional procedures to ensure that procedures and protocols are followed will benefit WECC as well as address the concerns raised by Audit Staff.

**Recommendation 9:** Submit the Board-approved WCC charter along with details of how the WCC relates to RDA activities to ensure the independence and confidentiality of the CMEP to the Audit staff for its review.

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<sup>56</sup> For example, NERC and the Regional Entities initiated the Technical Feasibility Exemption process in late 2009, after the Commission had already approved the 2010 Business Plans and Budgets. Resourcing that effort was a concern of WECC, and WECC Staff raised the issue to the WCC because of the potential number of requests and processes involved.

<sup>57</sup> For example, the WCC requested a briefing on WECC's position in response to the Commission's recent action in Docket No. NP10-18-000. As this issue could relate to WECC's compliance with the CMEP and NERC sanction guidelines, it is entirely appropriate for the corporation's Board of Directors to receive all relevant information.

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WECC concurs, in part, with this recommendation as a necessary part of the interaction with Audit Staff following audit. WECC hopes that additional discussions and subsequent clarifications regarding the WCC's governance role will address Audit Staff's concerns. WECC is concerned that this recommendation could be interpreted as requiring Audit staff's approval to continue the WCC. If that is the intent, then WECC does not concur with the recommendation.

**Recommendation 10:** Provide a written narrative explaining how WECC intends maintain or enhance the independence and confidentiality of the CMEP when considering any proposed changes to the WCC charter, including a process whereby WECC will inform the Commission of such impacts.

WECC concurs, in part, with this recommendation and will work with Audit Staff to develop a process during the reporting period after the Commission issues an order in this proceeding. WECC believes that the requirements outlined in the Commission's orders relating to FRCC and the NERC ROP Section 403 clearly identify the boundaries for independence of the compliance enforcement program. That policy can be incorporated into the governance documents to ensure that any proposed actions outside those limits is coordinated with NERC and filed with the Commission for approval before implementation. Internal governance issues such as this, however, do not require Commission approval as they relate to performance and management of corporate personnel.<sup>58</sup>

**Recommendation 11:** Develop a procedure to prevent the disclosure of confidential information.

Again, WECC concurs with recommendations that will improve its processes. This recommendation is similar to the recommendation discussed in subsection (b) above. Additional controls to prevent disclosure beyond the WCC, and appropriate limits on disclosure of information to the WCC, could be developed to alleviate both Audit staff's concerns and any potential concerns Registered Entities may have regarding confidential information.

- D. **The Draft Audit Report correctly describes the challenge faced by WECC after receiving nearly 5,000 self-reported violations in 2007, and the efforts to address the issues and promote reliability, which ultimately resulted in the Commission's approval of an omnibus filing in 2009 clearing certain minor violations identified prior to July 2008**

- (i) Findings

The Draft Audit Report accurately discusses the process and attempt by WECC to address a significant backlog resulting from a substantial number of self-reported and minor violations received during the first year of the implementation of the compliance enforcement program.<sup>59</sup> The original proposal was to limit the review of the mitigation plan completion notice, under the apparent authority of the Compliance Enforcement Authority to determine the review necessary

<sup>58</sup> CAISO v. FERC, 372 F.3d at 403.

<sup>59</sup> Draft Audit Report at 36-38.

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to verify that all required actions were completed.<sup>60</sup> WECC reviewed the proposal internally, issues relating to authority and violation period were identified, and WECC staff made a decision to implement and propose a process to NERC. After NERC raised concerns about the program, WECC reconsidered the implementation. This was an attempt to find a solution to a problem faced by WECC and other regions during the early phase of the implementation of monitoring and enforcement.

The Draft Audit Report, however, fails to discuss the subsequent filing and approval by the Commission of a similar effort to reduce the backlog of minor violations.<sup>61</sup> The violations in the Omnibus Filing reflected conduct by registered entities within the footprint of WECC, as well as five other Regional Entities. NERC stated in the filing that the matters in the Omnibus Filing represented older violations that were discovered prior to July 3, 2008, the date the Commission provided additional guidance to NERC on the filing of Notices of Penalty.<sup>62</sup> NERC stated, and the Commission accepted, that no significant reliability benefit would be gained by attempting to fully develop the record in each matter. Consequently, the Commission approved the proposal to close older, relatively minor cases in the Omnibus Filing so that NERC and the Regional Entities can concentrate on more significant violations.<sup>63</sup>

NERC and the Regional Entities together are engaged in significant activities aimed at monitoring status and progress of caseloads and workflow. The "High Impact List" is one method for focusing on significant violations and helping allocate resources. In addition, the "CITS" project (Compliance Information Tracking System) is in the implementation stage and will provide improved tracking of caseloads in all regions and NERC. Furthermore, WECC continues to prioritize and allocate resources as appropriate.

(ii) Recommendations

**Recommendation 12:** Work with NERC and the Commission to develop and implement plans to properly quantify and address WECC's current caseload, and work towards preventing future backlogs.

WECC concurs with this recommendation. With the completion of the Omnibus Filing, WECC has a manageable caseload of violations. WECC is processing new violations within acceptable timelines under the CMEP. While WECC continues to process a very small number of older violations, the project is nearly complete. WECC will continue to work with NERC to properly monitor its caseload and periodically will advise the Commission of those efforts.

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<sup>60</sup> WECC CMEP Section 6.6 ("Upon completion of the Mitigation Plan, the Registered Entity shall provide to the Compliance Enforcement Authority certification, signed by an officer, employee, attorney or other authorized representative of the Registered Entity, that all required actions described in the Mitigation Plan have been completed and shall include data or information sufficient for the Compliance Enforcement Authority to verify completion. The Compliance Enforcement Authority shall request such data or information and conduct follow-up assessments... *as it deems necessary [emphasis added]* to verify that all required actions in the Mitigation plan have been completed and the Registered Entity is in compliance with the subject Reliability Standard.").

<sup>61</sup> North American Electric Reliability Corporation, 129 FERC ¶61,119 at ¶38 (November 13, 2009) (the "Omnibus Filing").

<sup>62</sup> Guidance on Filing Reliability Notices of Penalty, 124 FERC ¶61,015 at ¶2-4 (2008) (July 3 Order).

<sup>63</sup> 129 FERC ¶61,119 at ¶40.

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WECC now considers lessons-learned when evaluating new compliance enforcement program activities and in discussing processes with NERC and the other Regional Entities.<sup>64</sup>

**Recommendation 13:** Contact the registered entities which had completed mitigation plans which were accepted under the initial backlog reduction plan, and inconsistent with WECC's CMEP. Inform these entities that the violation period will start from the date of the original self-report, if the entity is later found to still be out of compliance.

WECC concurs with the recommendations and will contact any Registered Entities to clarify the potential violation periods.

**E. Additional controls to avoid the appearance on any conflict of interest or undue interference by members can always be improved and formalized**

(i) Findings

While WECC's Standards of Conduct prohibits any a Board Director from using their position to confer special benefits on associated organizations or interest groups, during the course of the FERC Audit WECC identified the potential for a perception of a conflict of interest if a Board Director participated in an audit or enforcement action. WECC began discussing a Board policy regarding Board Director participation in compliance matters on behalf of the Board Directors employer or client. The Draft Audit Report provides sufficient guidance for WECC to finalize its policy and implement training.

(ii) Recommendations

**Recommendation 14:** Develop and implement a procedure for WECC employees to follow if they believe they have been inappropriately contacted by any member of WECC that would apply unless, and until, WECC oversight of the CMEP process is conducted by non-affiliated parties.

WECC concurs with this recommendation.

**Recommendation 15:** Implement a formal plan to avoid undue influence on WECC compliance staff when a WECC Board Director is a participant in an action; or, in the alternative;

**Recommendation 16:** Enforce a mandatory recusal process from all compliance actions for affiliated Board Director that would otherwise participate in CMEP actions involving their employers.

WECC concurs with these recommendations.

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<sup>64</sup> Most recently this discussion related to the Technical Feasibility Exceptions in the Critical Infrastructure Protection reliability standards.

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**Recommendation 17:** Present the plans and processes to avoid actual or perceived conflict of interests to the Commission Audit staff for its review.

WECC concurs with this recommendation.

**IV. CONCLUSION**

WECC believes that the steps it plans to take to implement the recommendations in the Draft Audit Report will improve WECC's operations. WECC disputes certain findings in the Draft Audit Report, but agrees to implement the recommendations proposed.

Sincerely,

A handwritten signature in black ink, appearing to read "SFG", is written over a large, faint, circular watermark or background mark.

Steven F. Goodwill  
Associate General Counsel