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NERC Audits for FERC Compliance: Lessons Learned

Meeting the Complex NERC Reliability Standards to Avoid Substantial Penalties

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Tuesday, February 23, 2010

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Complying with NERC Reliability Standards and Avoiding Penalties

Deborah Carpentier
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Agenda

- Compliance Programs
- Understanding the Audit Process
- Audit Preparation and Demonstrating Compliance
- Responding to Possible Violations

Why a Compliance Program?

- Numerous requirements & heavy potential fines
- An internal compliance program will help to identify and control risks that could result in violations and penalties
- ***To achieve and maintain compliance, effective policies, procedures, systems and controls must be in place, followed and kept up-to-date***

NERC Penalty Matrix

Appendix A

Appendix A: Base Penalty Amount Table

The following lists the Base Penalty amounts corresponding to combinations of violation risk factor and violation severity factor.

Violation Risk Factor	Violation Severity Level							
	Lower		Moderate		High		Severe	
	Range Limits		Range Limits		Range Limits		Range Limits	
	Low	High	Low	High	Low	High	Low	High
Lower	\$1,000	\$3,000	\$2,000	\$7,500	\$3,000	\$15,000	\$5,000	\$25,000
Medium	\$2,000	\$30,000	\$4,000	\$100,000	\$6,000	\$200,000	\$10,000	\$335,000
High	\$4,000	\$125,000	\$8,000	\$300,000	\$12,000	\$625,000	\$20,000	\$1,000,000

NOTE: This table describes the amount of penalty that could be applied for each day that a violation continues.

Monetary Penalties

- FERC recently indicated that zero or low dollar penalties often will be appropriate where:
 - Self-reported;
 - Mitigation plans promptly submitted and completed;
 - Lack of aggravating factors;
 - Significant cooperation;
 - Insubstantial expected or actual risk to the Bulk-Power System;
 - ***Especially where there is strong culture of compliance.***

Achieving a Compliance Culture

- A corporate compliance culture means that complying with the Reliability Standards is part of the job, not an impediment to doing “real work”
- Employees must:
 - Understand the applicable Reliability Standards
 - Be responsible and held accountable for complying with them
 - Attend training
 - Raise compliance concerns
 - Cooperate with any internal or external inquiry
- The Company must:
 - Provide tools and training
 - Address compliance concerns
 - Encourage cooperation
 - Provide compliance oversight
 - Engage in careful hiring

Communications and Decisionmaking

- ***A Compliance Program enables an employee to raise compliance issues, and have them addressed.***
- Affirmative duty to raise actual or possible violations
- No retaliation
- Safe channel of communication
- Address any issues raised
- Provide timely and clear guidance on critical compliance issues

Reliability Compliance Documentation

- ***Registered Entities should have written procedures in place to discuss how they will comply with applicable Reliability Standards.***
 - Sufficient to allow a third party to understand the company's processes
 - Cross reference relevant documents and
 - Contain a process for changing procedures and tracking revisions

Monitoring and Detection

- ***Internal procedures for monitoring and identifying possible violations, such as:***
 - Periodic self-assessments or gap analyses
 - Annual review of compliance procedures
 - Sharing of compliance information
 - Compliance calendar

Corrective Action and Sanctions

- ***A robust compliance program enables a company that has detected a possible violation to take timely corrective action.***
- Ceasing the questionable activity
- Requiring additional training
- Imposing disciplinary sanctions
- Submitting self reports and mitigation plan

Cooperation and Self Reporting

- ***Cooperation and Self Reports strongly encouraged***
- Cooperation, includes
 - Quickly identifying noncompliance, gathering facts, determining root cause, and correcting the problem
 - Notifying Regional Entity early in the process
 - Providing requested information in timely manner
 - Encouraging employees to cooperate with Regional Entity
 - Identifying responsible employees
- Consider self-report for compliance-related incident
- Ensure counsel is involved to ensure:
 - Fulsome investigation of potential noncompliance event and similar activities
 - No admission of violation where not appropriate
 - Evidence or mitigation steps are adequate for compliance



Navigating a NERC Audit

Chris Hajovsky

Director, Regulatory Affairs and NERC Reliability
Standards

RRI Energy, Inc.

February 23, 2010



UNDERSTANDING THE AUDIT PROCESS



Understanding the Audit Process

- *Audit Schedule Awareness* – Monitor the Regional Entity's three and six year audit schedules for your registered entity (where available).
 - *Example*: Both RFC and SERC lists the audit schedule for every registered entity for the next six (6) years.



Understanding the Audit Process

- *Audit Schedule Website Locations:*
 - NERC (master schedule for all regions for 2010 only):
http://www.nerc.com/files/2010_Public_Audit_Schedule_POSTED_1_29_10.xls
 - WECC (for 2010 only):
<http://compliance.wecc.biz/Application/ContentPageView.aspx?ContentId=193>
 - TRE (for 2010 only):
<http://texasre.org/compliance/audit/schedule/Pages/Default.aspx>
 - RFC (6-year): <http://www.rfirst.org/Compliance/Schedules.aspx>
 - SERC (6-year, at PDF page 20):
http://www.serc1.org/Documents/Compliance/2010%20Program/SERC_2010_Implementation_Plan_11_24_09-FINAL-with-attachments.pdf



Understanding the Audit Process

- *Audit Schedule Website Locations:*
 - NPCC (for 2010 only):
<http://www.npcc.org/viewDoc.aspx?name=2010+public+audit+schedule-5.pdf&cat=auditSpot>
 - FRCC (for 2010 only):
https://www.frcc.com/Compliance/Shared%20Documents/Compliance%20Audit%20Schedules/2010_Compliance%20Audit%20Schedule/2010%20Compliance%20Audit%20Schedule%20%20CIP%20Spot%20Check%20-%202010_27_09.pdf
 - SPP: (see NERC master schedule)
 - MRO (for 2010 only):
http://www.midwestreliability.org/02_compliance/audit_information/MRO_Compliance_Audit_Schedule.pdf



Understanding the Audit Process

- Formal Notice Letter – A Regional Entity is obligated to provide written notice of audit at least 60 days in advance.
- Documents Required
 - Pre-Audit Questionnaire
 - Reliability Standard Audit Worksheet (“RSAW”)
 - Evidence of compliance
 - Executive certification



Understanding the Audit Process

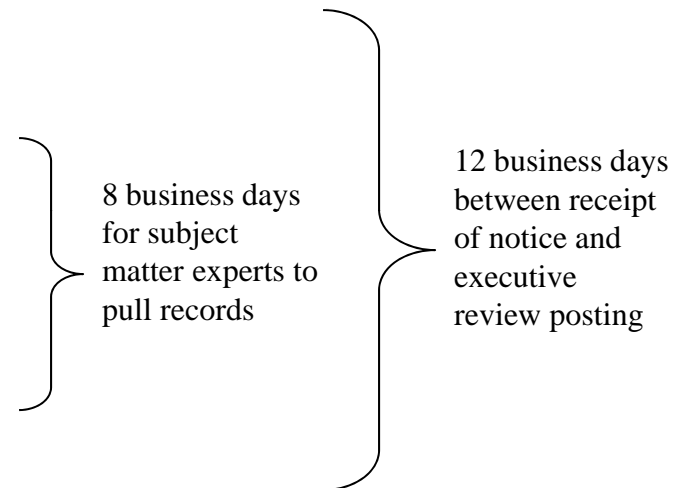
- Document Pre-Submittal – Most regions require pre-submittal of records up to 30 days in advance of the audit.
- Audit Types: In-person or “table top”
 - In-Person – Different approaches by Regional Entities
 - Some Regions allow the Entity to remain in the room, while others require the Entity to exit the room until requested.
 - Table-Top – Try and send someone in person to the Regional Entity offices.



Understanding the Audit Process

EXAMPLE OF AUDIT PREPARATION TIMELINE

1/9/2010	Receive Notice Letter from the Regional Entity
1/11/2010	Circulate audit notice to Standard Owners with schedule for audit preparation
1/21/2010	Documents due to Regulatory Affairs / Compliance for review and draft packaging
1/26/2010	Documents Ready for Executive preview
2/2/2010	Executive Meeting - required due diligence before signing certification letter
2/9/2010	Documents due to Regional Entity
3/9/2010	Audit Date





Understanding the Audit Process

- Audit Preparation Timeline
 - Gap in records will always exist (in the prior example, between 01/21 and 03/09)
 - Even if not required to submit 30 days in advance, it is logistically impossible to pull, package and submit all records the day before an audit
 - However, the audit period is defined as running through the date the audit begins
 - *Be prepared:* Auditors will ask about compliance during this gap



Understanding the Audit Process

- **Audit Preparation Timeline**
 - Lobby auditor and Regional Entities to revise the audit timeline to account for the realities of preparation and approvals. Recommended approach:
 - Send audit notice letter 90 days in advance of audit
 - Date of Notice Letter represents end date for records (e.g., count backward 90 days from date of the audit notice letter to determine data collection period for any requirements with 90 day data retention provisions)
 - Audit period runs between dates of audit letters, not dates of actual audits
 - Result:
 - No gaps in audit periods for Regional Entities, and
 - Much more comfortable document preparation and approval periods for Registered Entities



Understanding the Audit Process

- *In the Audit*
 - Questions by Auditors:
 - *In Writing*: Request that Auditor requests for *documentation* be memorialized in writing
 - *Impact to Reliability*: Always consider if the auditor question has an impact on reliability
 - *Language of Standard*: Always consider whether the Reliability Standard actually says what the auditor is suggesting it says



Understanding the Audit Process

- Post-Audit
 - Summary of findings presented by auditors
 - Seek to bring senior management to the summary presentation – Demonstrates corporate commitment to reliability
 - Potential violation(s) or full compliance?
 - All clear: Final report issued
 - Potential violation: Discussed below in more detail

Preparing Evidence

- No evidence = violation
- Registered Entities have burden of proof
- Prepare audit packages
- Evidence must be ready when audit begins

Preparing Evidence-RSAWs

- Reliability Standard Audit Worksheets, called RSAWs
 - Developed to facilitate compliance audits
 - Registered entity
 - Identifies Subject Matter Experts (SMEs)
 - Provides citation to documents demonstrating compliance
 - Responds to specific questions related to the standard
 - Audit team uses the RSAW to assess compliance
 - Be specific as to document, page number and section.
 - Complete set of RSAWs located at <http://www.nerc.com/page.php?cid=3|22>

Preparing Evidence—Internal Documentation

- Evidence should be contained in separate audit packages
- Seek objective evidence to demonstrate assertions of compliance, which could include:
 - Internal Procedures
 - Records
 - Log sheets
 - Reports/Memos
 - Diagrams
 - E-mails/Voice recordings
 - Screen shots
- Documentation and procedures that may have sufficed in the past for NERC compliance might not be sufficient now.

Who Should Prepare Audit Packages?

- Subject Matter Experts need to prepare these items in the first instance.
- They have first-hand knowledge of
 - Operations
 - Procedures
 - Documentary Evidence

Role of Counsel and Compliance Personnel

- Scrutinize and challenge evidence to:
 - Ensure the responses in RSAWs are responsive
 - Ensure evidence is audit proof as to:
 - Appropriateness
 - Sufficiency
 - Adequacy

What is Appropriate Evidence?

- **Relevant**

- Is it logically related to the requirement at issue?
- Does it prove what you are saying?

- **Reliable**

- Can it be substantiated when tested?

What is Sufficient Evidence?

- Is there evidence to demonstrate compliance with each facet of the requirement?
- Does the evidence connect the dots?
- Does evidence cover entire audit review period?

What is Adequate Evidence?

- Adequate evidence, particularly internal procedures, should contain among other things:
 - Title
 - Purpose
 - Date approved
 - Revision level
 - Effective date
 - Authorizing signatures
- A computer screen shot (if appropriate to demonstrate compliance with a requirement), for example, could be adequate evidence if date and time can be validated.



DEMONSTRATING COMPLIANCE



Demonstrating Compliance

- General Demonstration of Compliance Thoughts:
 - Burden of Proof: The Registered Entity has the burden of proof to demonstrate compliance (in the audit).
 - Availability of Personnel: Make certain that relevant personnel are on call for the entire duration of the audit.
 - Highlights: Highlight the key sections of the documentation to point the auditor to the appropriate section.
 - Many companies use Adobe Acrobat to create a master file with hyperlinks and bookmarks. They also embed documents in the same file, with hyperlinks added to the relevant RSAW questions



Demonstrating Compliance

- Event Driven or “as Requested” Evidence: “Proving the Negative”
 - Categories include:
 - Directives
 - Other requirements with specific action phrases such as:
 - When requested
 - Upon request
 - On Request
 - Shall respond to a request
 - As requested
 - As directed
 - Issue: Difficult to prove instances of these requirements never happened, or that the list the Registered Entity provides the auditor is comprehensive.



Demonstrating Compliance

- Event Driven or “as Requested” Evidence: “Proving the Negative”
 - Options for quality evidence of event driven requirements:
 - A Letter of Compliance
 - Signed by Authorizing Representative on record in NERC Compliance Registry
 - States that the evidence submitted is current and accurate, and reflects the current status of compliance by the Registered Entity
 - Confirmation through neighboring registered entities
 - Asks neighboring entities if they made any such requests to the Registered / Audited Entity, and if they have received the necessary information
 - Review of actual data or information
 - Request written documentation from the designated requesting entities



Demonstrating Compliance

- Corroborating Evidence
 - Multiple layers of evidence helps in two ways:
 - Provides depth to the auditors to ensure they have comfort
 - Provides the Registered Entity cover in the case an auditor does not accept one of the forms of evidence
 - Example: “Current, in-force” Sabotage Reporting procedure (CIP-001)
 - Procedure might have date of effect for version 2 of the document of July 1, 2009
 - Second layer of evidence might include screen shot of corporate policies and procedures webpage showing the date this version and previous versions were posted
 - Metadata: Increasing attention by Regional Entities to checking the hidden code in each file as a tool to verify the document is genuine, and not prepared simply in anticipation of the audit
 - Regional Entity trend toward requesting native files



Demonstrating Compliance

- Data Retention Period
 - Compliance Monitoring and Enforcement Program (“CMEP”) statements (both NERC and Regional Entity CMEPs) – “If a Reliability Standard does not require retention of data for the full period of the Compliance Audit, the Compliance Audit will be applicable to the data retention period specified in the Reliability Standard.”
 - See NERC CMEP, Section 4 at pages 10-11:
http://www.nerc.com/files/2009_NERC_CMEP_Implementation_Plan_final.pdf
 - NERC Process Bulletin #2009-005 – Current In-Force Document Data Retention Requirements
 - Example of January 2009 audit for CIP-001
 - Plant-specific records used June through September 2007
 - Sabotage Reporting procedure (corporate-wide) issued 09/2007
 - Corporate policy / procedure reduction effort in 2008
 - Does Registered Entity have obligation to retain June – Sept. 2007 records?



Demonstrating Compliance

- Data Retention Period
 - Major categories in Reliability Standards:
 - Current, in-force document
 - 90 days
 - Current year and prior calendar year
 - Full audit period (uncommon)

 - Stand firm with auditors – Some auditors still attempt to ignore the data retention period.
 - Regional Entity Argument: FERC only approved the “Requirements” in the Reliability Standards.
 - However: FERC approves the CMEPs, and therefore, auditors must honor the data retention provisions.



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What To Do If a Possible Violation Is Identified?

- Investigate
- Good faith argument
- If facts constitute a violation, or if in doubt, promptly self-report.
- Mitigation Plan

What to do if a Possible Violation is Identified (cont'd)?

- Submit Mitigation Plan
 - Corrects violation
 - Prevents recurrence
 - Tolls penalties in certain circumstances
 - Demonstrates commitment to compliance
 - Is NOT an admission of a violation or the appropriateness of penalty

Preparation of Mitigation Plans

- Typically, subject matter experts should be developing the milestones that will allow the company to attain full compliance with the standard at issue because
 - Technical details required
 - Milestones have to be achievable; risk increases if plan is not followed
- Company counsel or senior compliance personnel need to ensure that:
 - SMEs fully understand the requirements of a standard
 - Tasks set forth to mitigate noncompliance are doable
 - Compliance will be achieved by successful completion
 - Plan does not inadvertently admit to a violation prematurely

Closing Out Mitigation Plans

- Evidence of completion
- Regional Entity will audit the mitigated requirement
- Evidence must meet all of the same requirements as in compliance audit
- Keep in contact with the “Single Point of Contact” at your region to ensure they have the information needed

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