NERC Compliance in Practice

Creating an Effective Internal Compliance Program

Utilities & Energy Compliance & Ethics Conference
February 27, 2012

Presented by:
Andrew Gallo
Director, Reliability Compliance
512-322-6424
andrew.gallo@austinenergy.com

How might a strong Compliance Program affect a Violation Penalty?

• Mitigating factor toward reduction in penalty
• Agreed-upon improvements to Compliance Program during settlement can be “above and beyond” credits toward penalty
• Milestones are agreed upon and tracked to completion
• Milestones included in a Settlement Agreement
NERC Thoughts

- NERC encourages comprehensive compliance programs
  - FERC Policy Statement on Enforcement PL06-1 (10/20/05)
- NERC wants Compliance Program to:
  - Focus on effective internal controls prevention
  - Have effective incentives to promote compliant behaviors
  - Foster a “Culture of Compliance”

* T.J. Galloway, NERC Sr. VP/Chief Reliability Officer, presentation at 6/21/11 Chicago conference
(Slide 8)

Establishing a Compliance Program

- Plan
- Design
- Implement
- Monitor

Assume ~ 8-9 months to get from planning to implementing
Planning

- Personnel
- Budget
- Current/Former compliance docs (incl. training)
- Reporting processes
- Past compliance history (good record or bad)
- Previous assessments/audits/reports (internal/external)
- Conduct interviews
- Review I.T. systems
  - Databases
  - Alerts
  - Calendaring

Designing

- Inventory applicable laws, rules, regs
- Risk analysis
- Develop training goals/objectives
- Define communication goals/objectives
- Investigation, audit and enforcement models
- Record-keeping
  - Standardization
  - Forms
- Involvement level of Sr. Mgt/BoD
Designing (cont’d)

- Match compliance needs/gaps to available resources
- 5 / 3 / 1 year compliance plans
- Change management
- Sr. Mgt approval
- Announcements
- Identify staff for compliance functions
- Create policies/procedures
- Create ICP document & training materials

Implementing

- Create Compliance Committee
- Perform training
- Fill compliance roles across enterprise
- Post compliance program docs on web site
- Compliance metrics
- Systems support
  - Databases
  - Compliance-tracking software
  - Calendaring
  - Logging/Monitoring
- 360° Feedback
  - Continuous improvement
  - Plug gaps/lessons learned
Compliance Program

Essential Elements of a Compliance Program

1. Standards (or Code) of Conduct /Policies & Procedures
2. Compliance Officer/Compliance Committee
3. Education/Training
4. Monitoring/Auditing
5. Reporting/Investigating
6. Enforcement/Discipline
7. Response/Prevention

Standards (or Code) of Conduct/Policies & Procedures

- Prevent/detect unacceptable conduct
- Reduce likelihood of unacceptable conduct
- Apply to everyone (from BoD to volunteers)
- Easy to understand
- Incorporated into performance reviews (incl. discipline)
- Policies/Procedures
  - “Structural” = Framework (nuts and bolts) of how Compliance Program will operate
  - “Substantive” = Define applicable regs and how to comply; indicate applicable risk areas and describe appropriate/inappropriate behavior
Standards (or Code) of Conduct/ Policies & Procedures

- Policy – approach to an issue
- Procedure – how to implement a policy (include forms, if necessary)
  - “Child” of a Policy (no “orphan” procedures)
- Practice – what employees actually do
  - Should jibe with procedure (but don’t always)
- Guidelines - parameters w/n which the organization/individual should act
  - For areas not clearly identified by laws or regulations

IMHO - most business people will – ultimately – agree that developing policies/procedures helps their business processes/work flows

Compliance Officer/Compliance Committee

- Officer/Director/Manager
  - Design/implement/oversee/monitor the ICP
  - Report regularly to governing body (CEO/BoD Compliance Committee)
  - Develop/coordinate the education/training program
  - Ensure contractors/agents know ICP requirements
  - Assist in review/monitoring activities
  - Investigate and act on matters related to compliance
Compliance Officer/Compliance Committee

- **Compliance Committee**
  - Strong/Visible/Vocal compliance advocates
  - Advise Officer/Director/Mgr
  - Members from key groups (ops, legal, audit, H.R.)
  - CCO/Director/Mgr should sit *ex officio* and be chair
  - Compliance Office schedules meetings, makes agenda, takes minutes, *etc.*
  - Analyze requirements and risk areas
  - Assess adherence to policies/procedures
  - Review industry guidance and new information
  - Determine strategy
  - Solicit, evaluate and respond to issues/complaints

Education/Training

- **General** – for all employees (1-3 hrs per year)
  - Legal/regulatory knowledge for compliance activity
  - Company compliance philosophy
  - Compliance communications w/in and outside the organization
  - How compliance violations are defined and reported
  - Policy re: confidentiality
  - Vendors/temps held to same requirements as staff
  - Discipline for violations
  - Document retention
  - All employees should get Standards of Conduct and key compliance policies/procedures
Education/Training

• Specific – tailored with information appropriate to a group
  – How to properly perform their jobs
  – Can be one-on-one or on-the-job
  – Should include:
    • Background (why activity is necessary)
    • Operational practices
    • Form completion
    • Requirement of honesty
    • Duty to report misconduct

Education/Training

• Annual Education Plan
  – Needs, timing, methods, duration
  – Management buy-in (encourage/facilitate attendance)
  – Use various methods to educate
  – Include employees/contractors
  – Associate familiar with unfamiliar
  – Teach to all learning styles (listening, seeing, doing)
  – Use resources wisely (live=best; on-line; longer/more intense for certain employees in key areas)
  – Use real-life examples/scenarios
Monitor/Audit

- Constant Evaluation
- Continually improve compliance activities
- Review for:
  - Record retention
  - Tracking/reporting
- Compliance processes
- Two ways to audit:
  - Concurrent/Prospective - identify problems as (or before) they arise and cause harm; fix problems identified; go back several months later and re-check
  - Retrospective (not recommended) – provides a broad, baseline risk assessment; "snapshot"; remediate problems identified
- Random review of records

Monitor/Audit

- Federal government recommends:
  - On-site visits
  - Interviews with operational personnel
  - Questionnaires
  - Review of written materials/documents
  - Trend analyses
  - Review internal/external complaints
  - Include compliance language in job descriptions
  - Compliance-related questions in exit interviews

- Audits/reviews documented and reported to CEO/Compliance Committee
Reporting/Investigating

- Open line between CCO and personnel
- Open door
  - Employees must be comfortable reporting abuses
- No retaliation
- Confidentiality is key (including anonymity)
- Can use hotline/helpline (recommended)
- Post hotline prominently (bulletin boards, intranet)
- Once complaint is received, log/track & investigate
- Enumerate investigation steps
  - Limit distribution of investigation information

Enforcement/Discipline

- Fair, equitable and consistent
- Incentives
- Appropriate discipline for:
  - Unacceptable conduct or
  - Failing to take reasonable steps to prevent/detect unacceptable conduct
Enforcement/Discipline

- Main points:
  - Non-compliance will be punished
  - Failure to report non-compliance will be punished
  - Outline disciplinary procedure (verbal warning; written warning; suspension; fine; termination)
  - Define parties responsible for appropriate action
  - Discipline will be fair and consistent
- Minor infractions ➔ training
- Organizations should also use incentive programs, if possible

Response/Prevention

- Voluntary disclosure lessens fines
- Respond to/correct problems immediately
- Face problems ➔ fix them
- Detection means ICP is working
- Thorough investigation
  - Well documented
  - Use knowledgeable/objective investigators
  - Compliance office must be on team
Response/Prevention

- Thorough documentation
  - Description of problem/issue & how found
  - Description of investigation process
  - Documents reviewed
  - Employees interviewed
  - Employee interview questions and notes
  - Changes to policies/procedures, if appropriate
  - Disciplinary action
  - Final report with recommended remedial actions

Compliance Program Document

- Policy Statement
- Scope
- Definitions
- Roles & Responsibilities
  - Management
  - CCO/Director of Compliance
  - Responsible Managers
  - Responsible Employees
Compliance Program Document

• Compliance Monitoring
  – Review logs / Internal spot checks
  – Document reviews
  – Periodic independent third-party assessments
• Process for reporting violations
• Remedial Activities
  – Identify issue needing remediation
  – Owner
  – Contain/rectify
  – Root cause analysis
  – Solution
  – Follow up/monitor

Questions?
Practical Advice for Handling a NERC Compliance Audit

What To Do Before, During and After an On-site Audit

Before

- Be familiar with NERC Rules of Procedure
- Be familiar with GAO “Yellow Book”
- “Actively Monitored” Standards
- Begin preparing *long* before the audit
  - Document repository
  - Internal spot checks/audits
  - Have a multi-year plan for continuous compliance monitoring
  - Be aware of risk areas

**YOU CANNOT BEGIN PREPARING TOO SOON**
Before

- Conduct “Mock” Audit
- Review audit schedule
- Audit Notification Letter
- Review audit packet **carefully**
- Consider striking auditors
- Create list of Standards in audit

Before

- Develop list of SMEs
- Meet w/ SMEs to complete RSAWs
- Confidential information must be marked
- Draft narrative portion of RSAW
- Submit RSAWs and other evidence
- “Woodshed” SMEs just before audit
Before

- Meet with staff at audit site re: “audit etiquette”
- Prepare physical layout for audit – at least 3 rooms
- Put together a team to prepare audit area
  - IT
  - Admin Staff
  - Security
  - Compliance Office
  - Facilities
- Meet with Management Team
  - Expectations
  - Open / Closing Sessions

During

- Have SMEs on call
- Additional Evidence
- Conduct “De-briefings” at end of each day
- Keep Senior Management informed of status
- Replenish supplies

- Be flexible
- Be prepared to “bob and weave”
After

- Exit Briefing
- Audit Report
- Post-audit feedback form (to NERC)
- Lessons Learned
- Settlement Negotiations

**Possible Outcomes**

- Remedial Action Directives
  - May issue for “Imminent Threat”
  - Cease! (or impose other requirements)
  - Formal notice
  - Failure / refusal to conform = increased sanctions
After

- Mitigation Plans
  - Specific requirements of plans
  - “Reasonable” timetables
  - Milestones
  - Review and approval by RE
  - Completion Report

Questions?
Settlement Process

Utilities & Energy Compliance & Ethics Conference
February 27, 2012

Andrew Gallo
Director, Reliability Compliance
Austin Energy
512-322-6424
andrew.gallo@austinenergy.com

NERC Sanction Guidelines

• Appendix 4B to NERC Rules of Procedure

• Sanctions (§3.1):
  – Promote compliance
  – Deter future incidents
  – Implement actions to correct behavior
  – Disgorge benefits
NERC Sanction Guidelines

• §3.3 – You may request settlement negotiations at any time
  – NERC or RE may decline

• Penalty determined when violation is confirmed or settlement reached (§3.5)

• Penalties must bear “reasonable relationship” to seriousness of violation (§3.8)

NERC Sanction Guidelines

• Determining Monetary Sanction (§4)

  – Step 1: Determine Base Penalty (VRF & VSL)
    • May be highest amt in matrix (§4.2)
    • May be below lowest amt in matrix (§4.2)
      – Look at VRF applicability to case’s facts
      – First violation discretion
      – Time Horizon
## Matrix

<table>
<thead>
<tr>
<th>Violation Risk Factor</th>
<th>Lower Range Limits</th>
<th>Moderate Range Limits</th>
<th>High Range Limits</th>
<th>Severe Range Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower</td>
<td>Low $1,000</td>
<td>High $3,000</td>
<td>Low $2,000</td>
<td>High $7,500</td>
</tr>
<tr>
<td>Medium</td>
<td>Low $2,000</td>
<td>High $30,000</td>
<td>Low $4,000</td>
<td>High $100,000</td>
</tr>
<tr>
<td>High</td>
<td>Low $4,000</td>
<td>High $125,000</td>
<td>Low $8,000</td>
<td>High $300,000</td>
</tr>
</tbody>
</table>

Determining Monetary Sanction

- Step 2: Apply Mitigating / Aggravating Factors
- Factors:
  - Size of violator
  - Violation time horizon
    - Real-time events have higher sanction than long-term (e.g. planning) events
  - Extenuating circumstances (e.g. natural disasters)
  - Concealment of violation
Determining Monetary Sanction

• Factors (cont’d)
  – Intentional violations
  – Economic choice to violate
  – Violation frequency
  – Violation duration
  – Self-report
  – Quality of Compliance Program

• Step 3: Assess entity’s ability to pay

Compliance Monitoring & Enforcement Program (CMEP)

• NERC Rules of Procedure – Appendix 4C
  – Notice of Alleged Violation (NOAV) (§5.3)
    • Standard/Requirement violated
    • Date(s) of violation
    • Facts supporting alleged violation
    • Proposed penalty
      – Incl. explanation of basis for penalty
Compliance Monitoring & Enforcement Program (CMEP)

– Within 30 days, you must choose:
  • Agree to violation & penalty
    – Submit Mitigation Plan
  • Agree to violation (and submit Mitigation Plan) but dispute penalty
  • Contest violation *and* penalty
– You may submit Mitigation Plan even while contesting violation/penalty
– If you contest, you may request a hearing

Compliance Monitoring & Enforcement Program (CMEP)

– No response w/n 30 days = acceptance of violation/penalty
– **If you want to negotiate, respond w/n 30 days!**
– To contest, submit response with your position
  • Signed by officer, employee or agent *(e.g. lawyer)*
– RE should schedule a conference w/n 10 days
Compliance Monitoring & Enforcement Program (CMEP)

– If no settlement w/n 40 days of when you submitted your position, you may request a hearing

  • 40 days can be extended by agreement

Settlement Negotiations

• You can request negotiations at any time
  – Even before NOAV is issued
• RE can decline after Possible Violation / Alleged Violation becomes a Confirmed Violation
• NERC notified of settlement negotiations
  – May participate
• Settlement negotiations are confidential until settlement becomes final (NERC approval)
Settlement Negotiations - What You Must Do

• Request settlement negotiations
• Designate person authorized to negotiate
• **Read NOAV carefully!**
  – Ensure:
    • You understand allegations
    • Facts are accurate
    • Violation start date/end date are correct
    • Requirements are correct
• Talk to your friends and neighbors
  – Many will share experiences

Settlement Negotiations – What You Must Do

• Consider whether to hire an attorney
• Formulate position
  – Contest violation?
  – Contest penalty?
  – Contest both?
• Review NERC Enforcement Page* for similar events
  – Review facts
  – Review penalties
• My advice: do not submit written “Position Paper”

NERC Position on Penalties

• “The focus of NERC’s compliance efforts is to ensure the reliability of the bulk power system in North America by fairly and **consistently** enforcing compliance with our standards.”* (emphasis added)

• “Promote **consistent outcomes** across the Regional Entities for violations of similar standards involving similar registered entities”** (emphasis added)


** Rebecca Michael, NERC Associate General Counsel – 6/21/11 NERC Compliance Workshop (Chicago)

---

Settlement Negotiations

• Schedule settlement meeting
• Conduct pre-meeting prep session
• Attend meeting w/ RE staff
• Debrief/Caucus
• Determine whether to counter-offer
  – “Take it or leave it”
• Reach ultimate agreement
Settlement

• After agreement reached
  – Coordinate with RE on Settlement Agreement
  – Ensure everything in draft agreement is correct
  – Decide whether to submit “Statement”
    • Placed on NERC Enforcement web page with NOP
  – Review with Management

Post-Settlement

• Housekeeping
  – Get RE set up in AP system
  – “Bird dog” the settlement payment
  – File Settlement Agreement
  – Inform relevant staff
• Root Cause Analysis
  – Implement steps to prevent recurrence
• Discipline or training?
Questions?