



**COMMENTS OF THE**  
**MIDWEST RELIABILITY ORGANIZATION**  
**BOARD OF DIRECTORS**  
**May 29, 2009**

Overall, the Midwest Reliability Organization (“MRO”) agrees with many of the comments and suggestions for improvement made by the North American Electric Reliability Corporation (“NERC”) in its assessment of itself and the Regional Entities. In order to view the comments and proposals for improvement in an appropriate light, it is important to review the accomplishments of NERC and the Regional Entities in the short period of time since the passage of the Energy Policy Act of 2005 and certification of NERC as the Electric Reliability Organization.

While there are areas in need of improvement, there has also been a tremendous amount of success over the last three years. As the Regional Entities point out in their joint assessment, the Regional Entities have registered 1,845 owners, operators and users of the Bulk-Power System; processed approximately 5,000 compliance violations; and conducted over 500 audits.<sup>1</sup> In addition, the Regional Entities have held numerous compliance workshops on the development of compliance programs, areas for improvement and lessons learned. While no process is perfect, a great deal of progress has been made. However, there are areas particularly related to compliance monitoring and enforcement, which must be improved. NERC and the Regional Entities have focused on many of these areas. MRO seeks to provide its perspective on some of those areas including: (i) Regional Entity consistency and NERC oversight; (ii) Regional Entity governance; (iii) compliance and enforcement; (iv) relationships with cross-border entities; and (v) other program comments.

**I. REGIONAL ENTITY CONSISTENCY AND NERC OVERSIGHT**

In its assessment of the Regional Entities, NERC observes that:

*Numerous stakeholder comments pointed to the need for NERC to take a stronger leadership role in eliminating differences among Regional Entities and to ensure uniformity and consistency across all regions. Some commenters stated that participation of NERC personnel in audits helps promote inter-regional consistency; some suggested additional presence by NERC staff on compliance audits.<sup>2</sup>*

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<sup>1</sup> See *Joint Regional Entity Self-Assessment*, at 3. The Joint Regional Self-Assessment also highlights several other areas of achievement related to development of Reliability Standards, compliance monitoring, enforcement and mitigation.

<sup>2</sup> See *NERC Assessment of Regional Entities*, at 11.





MRO agrees that uniformity and consistency (both in process and results) are critical. MRO does not support the notion that earlier engagement by NERC in the discovery methods, such as audits, will result in greater uniformity and consistency. Instead, MRO believes uniformity and consistency can be accomplished through a focus on clarifying the roles and responsibilities between the Regional Entities and NERC, improved training of NERC and Regional Entity staff, and establishment of adequate controls in the form of standardized systems, procedures and processes to successfully implement a decentralized model.

Towards that end, NERC has undertaken to update the current Reliability Standard Audit Worksheets. NERC also believes that a single central data hub, which provides seamless data management, is necessary.<sup>3</sup> MRO agrees, and that it should be a managed solution through a qualified vendor with NERC as the contract administrator. Rather than focusing on a single aspect of consistency, such as data management, the focus should be on whether there are adequate controls (*e.g.* training, uniform systems, processes, and procedures) to deliver consistent outcomes. MRO would emphasize that controls are necessary to establish a “band” of consistency without a “cookie-cutter” approach to compliance monitoring and enforcement. There are numerous circumstances, facts, and other considerations that preclude identical enforcement decisions. Prudent judgment cannot be displaced through automation. In fact, one of the values of the centralized/decentralized model is that the Regions, being familiar with the specific characteristics of their “footprint”, can take these characteristics into account with regard to meeting delegated responsibilities. However, both Regulators and Registered Entities must be able to look across NERC and the Regions and see consistent application of the requirements of the standards, and the process steps, in handling a compliance finding, should be nearly identical in the United States.

Additional training of Regional Entity and NERC staff would facilitate greater consistency in the compliance and enforcement area. NERC has made progress in this area over the last few months, however; MRO is concerned that this important training for NERC and the Regional staff competes with other priorities in the overall training area. MRO suggests that NERC dedicate more resources to coordinate the field training for NERC and Regional staff with an emphasis on the compliance and enforcement area. Registered Entity training should be a separate function with a focus on meeting the requirements of the Reliability Standards. This Registered Entity training could be part of a revised “readiness” program with an emphasis on preparation and prevention through compliance. NERC should seek input from Registered Entities on what’s needed to better prepare themselves for new Reliability Standards and how to improve compliance with existing standards. A “well educated” set of Registered Entities will improve compliance and make enforcement more effective in addressing reliability matters.

NERC also should take a hard look at whether it has adequately defined the roles and responsibilities between the Regional Entities and NERC. MRO believes that this still is evolving, and it has nothing to do with the delegation model; it has more to do with managing through a decentralized model in a start-up. NERC should work with the Regions to establish the parameters of what should be centralized versus what should be decentralized; this would

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<sup>3</sup> *Id.* at 12-13.





help address implementation tensions between NERC and the Regional Entities, avoid duplication in the budgeting process, and optimize operations at NERC and the Regional Entities.

The performance issues in the compliance and enforcement area are more related to implementation, rather than the design of the self-regulatory model. This is understandable given the breadth and scope of the undertaking. At this time, NERC should re-evaluate its management plan to better align with decentralized implementation. Fundamentally, NERC must establish the systems, procedures and processes (*i.e.* controls) to successfully implement a decentralized model over the long term and truly leverage the existing infrastructure, resources and knowledge in the Regions. The start-up investments already made in the decentralized model need the opportunity to mature so the true benefits can be realized over the long term. MRO agrees with NERC that upfront performance metrics, coupled with well designed controls and a management plan for decentralized implementation, would improve consistency and efficiency.<sup>4</sup> However, MRO believes that the implementation was faster and quicker because NERC leveraged an existing infrastructure with trained resources.

As NERC proposes, it should invest in standardized systems, procedures and processes to eliminate the expensive redundant work between the Regions and NERC and would drastically reduce the variability in implementation of compliance and enforcement across the Regions. Outsourced partnering arrangements with qualified third parties are needed to jump start this. A deliberate organization design centered on decentralized implementation whereby NERC designates sufficient staff resources to deliver fast, concrete improvements through standardized systems, procedures and processes is needed.

NERC also needs to apply a bottoms-up approach to implementation in the Field rather than adding more top-down structure. For example, rather than hiring new auditors to address cyber security issues at nuclear plants, NERC would be better served by training existing Regional Entity staff to meet the requirements. MRO understands that in order to employ a more bottoms-up approach, NERC must be assured that Regional Entities have “clean” processes and procedures, free of conflicts. In its assessment, NERC alludes to more scrutiny on the non-statutory functions and affiliations of Regional Entities:

*Further, the Compliance Monitoring and Enforcement Program must be managed independently of the users, owners, and operators. While it is appropriate, indeed important, that Regional Entities in some instances are users, owners, and operators of the bulk power system, those activities must be kept entirely separate from the Regional Entities’ management and implementation of the compliance program. In addition, for NERC to delegate authority to a Regional Entity, NERC will insist that the delegated functions be either the exclusive functions or vast majority of the functions reporting to the Regional Entity executive.*

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<sup>4</sup> See NERC Three-Year ERO Performance Assessment at 29





MRO believes that all statutory delegated functions must be carried out in an “arms length”, non-discriminatory fashion. MRO suggests that NERC consider changes to the next Regional Delegation Agreements and should not limit the scope to compliance and enforcement. For example, use of stakeholders and Registered Entities in any discovery aspects or enforcement determinations under the CMEP should not be permitted other than to act as Hearing Bodies for contested matters under the Rules. NERC should standardize and document the process from compliance discovery to enforcement decisions. This could help assure proper safeguards are in place and provide useful information to the Registered Entities.

## II. REGIONAL ENTITY GOVERNANCE

In its three year assessment, NERC makes the following statement:

*Finally, while stakeholder and hybrid boards are appropriate and have proven successful for most of the delegated activities, NERC believes the time has come for all compliance programs to report to independent directors . . . [T]he time has come to remove the subtle and not-so-subtle influences over compliance staff that can come from having to carry out enforcement activities against some of the same entities that have control over compensation and budgets.*

*NERC recognizes that §215(e)(4)A)(i) of the [Federal Power Act] states that the Commission may approve a delegation agreement with a Regional Entity if (among other criteria) the Regional Entity is governed by an independent board, a balanced stakeholder board, or a combination independent and balanced stakeholder board. But the delegation of authority under §215(e) (4) is not mandatory, and NERC could elect to enter into a delegation agreement only with a Regional Entity governed by an independent board. NERC believes the statutory option of using a hybrid board would be a way to implement this new approach.*

MRO disagrees with the notion that balanced stakeholder boards are *per se* discriminatory. NERC has offered no factual support for such a conclusion. Moreover, while the delegation of authority is not mandatory, it would be difficult for NERC to sustain a revocation of delegated authority based upon general uneasiness about a board structure specifically approved by federal statute. NERC’s comments also do not adequately address the conflict of interest procedures already in place to ensure activities of Regional Entity staff are carried out in a non-discriminatory manner. NERC established conflict of interest rules via the CMEP and its Rules of Procedures. In addition, MRO and other Regional Entities have supplemented the rules with their own regional policies and procedures in order to better address the perceived and potential conflicts. In other words, concerns about Regional Entity conflicts must consider the existing NERC rules and those already adopted by the Regional Entities. NERC then can identify specific impairment risks in the existing processes and propose solutions. Therefore, the question is whether the existing NERC and Regional Entity rules are sufficient to address the perceived or potential conflict of interest. Further, MRO believes that it





has a duty to maintain the public trust and must carry out all its delegated functions, in an independent fashion, free of conflicts, and this is not limited to compliance and enforcement.

While MRO acknowledges the potential and perceived conflict of interests in governance structures, no governance structure can provide absolute assurance from the risk of a conflict of interest. The balanced stakeholder governance structure in the field recognizes the interdependencies of the industry among those responsible for ensuring the reliability of the Bulk-Power System. NERC should review other options to address the perceived conflict of interest, including strengthening the existing NERC Rules of Procedure and providing more standardization of processes around how enforcement decisions are made in the field (*i.e.* controls). In addition, NERC should seek much closer organizational affiliations with Regional Entities, preserving the local regional stakeholder's role while addressing the perceived or potential conflicts.

### III. COMPLIANCE MONITORING AND ENFORCEMENT

NERC states that many commenters expressed their concerns regarding “the volume of work facing the Regional Entities and NERC as well as the desire to see violations, settlements and mitigation plans processed to completion, and therefore made public, in a more expeditious manner.”<sup>5</sup> NERC further states that, “[w]ith the number of violations reported in the first 18 months of mandatory reliability standards, prioritization of the violations by NERC and the Regional Entities is necessary. Prioritizing based on the risk to reliability or the violation risk factor is one method, however; a registered entity is likely to want to process all of a registered entity's violations in a single settlement agreement or other enforcement action.”<sup>6</sup>

NERC proposes a number of changes to help facilitate the backlog of cases. NERC proposes multi-regional settlements for Registered Entities crossing several regions. Because approximately 50 percent of the violations have been documentation-related violations (*i.e.* the entity is performing the necessary process but does not have the paperwork to support its performance), NERC proposes a process by which documentation-related or low risk violations would be separated from those higher risk violations that impact the Bulk-Power System. One way to address this is for the Commission to accept an abbreviated record from NERC and a Regional Entity regarding minor, low risk violations. Similar to a “speeding ticket”, this would help in allocating resources between low and high risk violations. Currently, the administrative costs are nearly identical for low risk and high risk violations because the process is the same for both. Another way to address this is to provide more discretion to the Regional Entities. For example, all violations should be reported and tracked for completed mitigation, but not all violations would be prosecuted through the existing enforcement procedures. Segregating those violations which pose a greater threat to Bulk-Power System reliability from minor, low risk violations would properly align resources in the field and at NERC.

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<sup>5</sup> *Id.* at 14.

<sup>6</sup> *Id.* at 17.





In conclusion, MRO supports efforts to streamline the process while preserving adequate due process protections. By having the ability to process routine or low-risk violations quickly and efficiently, Regional Entities and NERC can focus staff and resources on those issues crucial to the reliability of the Bulk-Power System.

#### **IV. RELATIONSHIPS WITH CROSS-BORDER ENTITIES**

MRO has worked diligently with its Canadian members to establish structure that will support the reliability of the cross-border Bulk-Power System. Towards that end, MRO has signed an agreement with Manitoba Hydro by which reliability standards are binding and enforceable on Manitoba Hydro until such time as legislative authority is adopted in Manitoba. Likewise, MRO has signed an MOU with Saskatchewan Power Corporation (SPC), covering the respective roles of the parties regarding reliability and monitoring compliance with reliability standards.

While the regions with cross-border members and those subject to reliability standards have made progress in establishing a framework for compliance, NERC should look for opportunities to assure that any Reliability Standards being proposed are thoroughly reviewed by Canadian authorities, with equal time and proportional weight given to the views and opinions of regulatory authorities in the United States and Canada. The goal should always be a common set of Reliability Standards recognized in all jurisdictions of North America. NERC must also work with cross-border entities and the Commission to establish proper protocols for the sharing of information related to system events and other reliability investigations. The sovereign rights of cross-border entities must be respected and access to confidential information protected.

#### **V. OTHER PROGRAM AREAS COMMENTS**

MRO offers the following comments on other program areas:

*Reliability Standards Development.* NERC states that work on the “fill-in-the blank” Reliability Standards has not been completed, and that stakeholders commented on the need to complete this effort in order to eliminate the potential gap in reliability and provide certainty to the registered entities on the application of these standards. According to NERC, fifteen of twenty-four “fill-in-the-blank” standards are actively being addressed by NERC Standard Drafting Teams with completion anticipated in early 2010. The remaining nine are included in projects slated to commence in 2010.<sup>7</sup>

MRO believes that NERC must set priorities based on risk to the Bulk-Power System, focusing on those most crucial to the system. Towards that end, MRO supports finalizing the “fill-in-the-blank” Reliability Standards before any new Reliability Standards are considered.

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<sup>7</sup> *Id.* at 7.





MRO supports this position because the “fill-in-the-blank” Reliability Standards in many instances are referenced by other current Reliability Standards. In other words, not only is a subset of the original Reliability Standards not final, they are also cross-referenced by enforceable standards making compliance with the enforceable standards unclear for Registered Entities. MRO also suggests that if NERC believes that a North American or Interconnection-wide standard for the “fill in the blank” standards cannot be achieved within the next two years, it should direct the Regional Entities to propose such standards to be approved and enforced until such time they are superseded by a North American or Interconnection-wide standard. MRO preference has been North American and Interconnection-wide standards rather than a proliferation of Regional standards, however; if the “fill in the blank” standards cannot be timely proposed and completed at the North American or Interconnection-wide levels, the Regional Entities should be directed by NERC to propose these standards as an interim measure and Regions should be encouraged to work jointly.

*Organization Registration.* MRO supports Joint Registration and recognition that registration is an on-going process which needs a management plan to improve and refine the process over time. MRO strongly supports a North American inventory of all the bulk power system elements as a means to establishing a more accurate registration and the eventual registration by requirement. Only those who have an impact on bulk power reliability should be on the registry. Although Joint Registration already accommodates registration by requirement, Joint Registration presumes a relationship or agreement exists between those on the joint registry. MRO would propose that registration by requirement would carry no such presumption. In addition, MRO strongly objects to the “splitting” of requirements to different registered entities without a carefully constructed matrix of responsibilities that provides a clear line of sight responsibility. In the 2003 Blackout Report, poorly understood responsibilities of those who operate the system were a contributing factor to the widespread disturbance.

*Reliability Readiness Evaluation and Improvement Program.* Reliability readiness and improvement should be closely linked with Training, Education, and Operator Certification. NERC needs to establish a process whereby Registered Entities can ask questions regarding compliance with certain requirements and NERC can provide non-binding answers to Registered Entities; assisting in compliance with the standards.

*Training, Education and Operator Certification.* MRO supports more education and training for the Registered Entities so that they are knowledgeable of the requirements of the Reliability Standards. MRO believes that the training for Regional Entity staff should be done outside of the scope of this program area and be included as a separate function which supports the Regional Entities and NERC staff.

*Reliability Assessment and Performance Analysis Program.* MRO acknowledges that there have been significant gains made in the assessments function of NERC. An unintended consequence of the NERC Rules of Procedure is that lessons learned from events and disturbances are not adequately shared with the industry. MRO believes that NERC should establish a single, independent disturbance analysis process which is focused on “what happened” and is separately staffed (the function should be “arms length” from enforcement, similar to the relationship





between the National Transportation Safety Board and the Federal Aviation Administration). The disturbance report from this “arms length” team should then be forwarded to compliance staff for potential enforcement and mitigation, to the NERC Planning and Operating Committees, and to other industry stakeholders to share “lessons learned” and recommendations for improvements through the standards. Disturbance analysis represents the single largest opportunity to improve system reliability. Timely, shared lessons learned from real events provide extremely valuable information on how to prevent disturbances in the future and is a source for new standards and improvements to existing standards. MRO urges NERC to add more resources for this function and address the barriers which have resulted in less sharing of information on disturbances with those responsible for Bulk-Power System reliability.

Thank you.

