

126 FERC ¶ 61,045
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Southwest Power Pool, Inc.

Docket No. PA08-2-000

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

(Issued January 15, 2009)

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. The Report contains staff's findings and recommendations with respect to Southwest Power Pool, Inc.'s (SPP's) Regional Entity (RE) function.¹ The audit addresses SPP's compliance with (1) the SPP, Inc. Bylaws, (2) the Delegation Agreement between the NERC and SPP, and the conditions included in the relevant Commission orders, and (3) other obligations and responsibilities directed by the Commission.
2. This audit was intended to enable the Commission to determine whether SPP's governance structure creates a "very strong" separation between its RTO and RE

¹ As an RE, SPP is responsible for enforcing the mandatory electric reliability standards of the North American Electric Reliability Corporation (NERC) that the Commission approved. SPP also operates as a Regional Transmission Organization (RTO). *Southwest Power Pool, Inc.*, 106 FERC ¶ 61,110 (2004). For purposes of this order, we refer to SPP's RTO function as SPP (RTO) and SPP's RE function as SPP (RE).

functions, as required by the Commission in Order No. 672.² In subsequent orders addressing the NERC-SPP Delegation Agreement, we reserved our determination on this issue pending the conclusion of the audit.³ Nevertheless, the OE staff took into account that SPP (RTO) is the newest organized electricity market approved by the Commission, and that this audit was conducted during a transitional period when SPP was establishing its RE operations for overseeing more than 120 registered entities in eight states in the southern and southwestern United States. Accordingly, the OE staff recognized that SPP (RE) faced many challenges to start up a new (reliability) function within SPP (RTO).

3. Staff informed SPP of their audit findings and recommendations in a draft audit report on September 10, 2008, as revised on November 19 and December 3, 2008, to reflect comments made by SPP. The Report found that SPP did not have an adequate separation between its RTO and RE functions during the audit period, May 18, 2007 through August 30, 2008. Specifically, during the audit, OE staff found three main areas of concern. First, SPP (RE) did not operate with sufficient independence of SPP (RTO). Second, SPP (RE) trustees' oversight of the SPP (RE) functions could be improved to prevent conflicts of interest and to ensure the RE's independence. Third, the SPP (RE)'s implementation of certain aspects of SPP's Compliance Monitoring and Enforcement Plan (CMEP) was inadequate.

4. While not agreeing with all of the principal findings and conclusions in the Report, SPP agreed to adopt all of the recommendations in the December 3, 2008 draft of the Report, with one exception. SPP requested that OE staff reconsider this single recommendation. In light of additional comments provided by SPP, OE staff removed this recommendation from the Report, which is now final, dated December 22, 2008, and attached to this order.⁴ As a consequence, SPP has agreed or has already begun to undertake all of the recommended corrective actions. Of particular note, SPP will hire a

² *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 698-700, *order on reh'g*, Order No. 672-A, FERC Stats & Regs ¶ 31,212 (2006).

³ *See, e.g., North American Electric Reliability Corp.*, 119 FERC ¶ 61,060 (Delegation Agreements Order), *order on reh'g*, 120 FERC ¶ 61,260 (2007) (Delegation Agreements Rehearing Order), *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).

⁴ The exception pertained to the registration of a particular user, owner or operator, a matter that on balance was unnecessary to consider in the audit.

Regional Manager dedicated solely to SPP (RE) and eliminate all reporting relationships between SPP (RE) and SPP (RTO) employees.

5. Based on the results of the audit and SPP's agreement to implement the Report's recommendations, we conclude that upon implementation of the recommendations, SPP prospectively will satisfy the requirement that its governance structure creates a "very strong" separation between its RTO and RE functions, as Order No. 672 specifies for Regional Entities that include or that are affiliated with an RTO or an Independent System Operator (ISO). We condition this conclusion on SPP's timely and effective implementation of the Report's recommendations, including the filing of a compliance plan as specified below.

Background

6. In Order No. 672, the Commission discussed the generic issue whether an RTO or ISO may have an inherent conflict of interest if it is also a Regional Entity. The Commission pointed out that such an entity would operate the Bulk-Power System and be responsible for overseeing its own compliance with Reliability Standards. The Commission found that "such self-enforcement is extremely difficult to carry out satisfactorily" and that a "system operator/Regional Entity in a single corporation -- absent a very strong separation between the oversight and operations functions -- should not oversee its own compliance with Reliability Standards."⁵ Accordingly, while not prohibiting such an entity seeking to be a Regional Entity from "making its case" for adequate separation of its compliance oversight and operational functions, the Commission stated: "[A]n RTO or ISO that lies in whole or in part within the United States and applies to become a Regional Entity will have a heavy burden to show that it meets the statutory criterion that it be independent of the operators of the Bulk-Power System in its region."⁶

7. The Commission conditionally approved SPP as an RE on April 19, 2007, in the Delegation Agreements Order that, *inter alia*, approved NERC's Delegation Agreement with SPP and NERC's CMEP, subject to certain revisions to be accomplished through a compliance filing.⁷ In the Delegation Agreements Order, we indicated that with respect to this approval, we were relying on SPP's assertion that "the SPP Regional Entity trustees will be the final arbiter regarding each of the reliability functions and duties

⁵ Order No. 672 at P 698.

⁶ *Id.* P 699 (footnote omitted).

⁷ Delegation Agreements Order at P 375-76.

delegated to SPP.”⁸ We further indicated that we were not convinced of “the ability of the SPP RE trustees to act independently of the RTO in matters relating to their appointment, compensation, the preparation and control of budgets, the separation of personnel, the development of reliability standards and in other matters subject to the oversight and control of the SPP board.”⁹ We directed SPP to modify its bylaws to ensure that “the independence of the SPP Regional Entity trustees in standards development and as otherwise discussed will not, in fact, be compromised, directly or indirectly, by the SPP board.”¹⁰

8. In the Second Delegation Agreements Order, issued on March 21, 2008, we approved SPP’s revisions to its bylaws submitted in response to the Delegation Agreements Order. However, we stated that we “remain concerned regarding the adequacy of the separation of functions between the SPP RTO and SPP Regional Entity.”¹¹ We observed that the RE’s organizational chart showed only four RE employees,¹² including the executive director for compliance, and stated that we are concerned “whether the full time staff dedicated to Regional Entity functions can support adequate reliability oversight in the SPP region.”¹³ We stated further that “we are concerned about whether SPP Regional Entity’s reliance on shared professional employees, including engineers and attorneys, and potentially management, allows for a strong separation of functions as contemplated by the Commission in Order No. 672.”¹⁴ Finally, we indicated that we had initiated the instant audit into “SPP Regional Entity’s organizational structure and practices” and that a final determination regarding the adequacy of the separation of functions between SPP (RE) and SPP (RTO) would remain pending the results of the audit.¹⁵

9. We recently reiterated in the Third Delegation Agreements Order that our final determination regarding the adequacy of the separation of functions between SPP

⁸ *Id.* P 397.

⁹ *Id.*

¹⁰ *Id.* P 398.

¹¹ Second Delegation Agreements Order at P 212.

¹² SPP (RE) added a fifth full-time staffer in April 2008.

¹³ Second Delegation Agreements Order at P 212.

¹⁴ *Id.*

¹⁵ *Id.*

Regional Entity and SPP RTO will continue to remain pending until the results of the audit are complete.¹⁶

The Audit

10. Against this backdrop, on October 4, 2007, OE staff issued a public letter to SPP in this docket announcing that they were commencing an audit to determine whether SPP was in compliance with: (1) SPP's Bylaws,¹⁷ (2) the Delegation Agreement between NERC and SPP and the conditions included in the relevant Commission orders, and (3) other obligations and responsibilities, as approved by the Commission. In particular, in the ensuing audit, OE staff looked at the relationship between SPP (RTO) and SPP (RE). In this regard, they took into account that NERC had registered the SPP (RTO) as conducting numerous functions relating to the Reliability Standards, including Reliability Coordinator, the highest level of authority with responsibility for the reliable operation of the bulk-power system. NERC had also delegated to SPP (RE) the following major program functions:¹⁸

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.

11. During the audit period, as OE staff auditors learned, the SPP (RE) staff performed and administered function 3 while SPP (RTO) staff and other stakeholders served as volunteer participants. Staff shared by SPP (RTO) and SPP (RE) exclusively performed three of these functions (5, 6, and 7); SPP (RTO) and SPP (RE) staff performed function 4; and the SPP (RE) staff solely performed function 2. Function 1, developing reliability standards, was performed initially by an SPP (RTO) stakeholder

¹⁶ Third Delegation Agreements Order at P 112.

¹⁷ *Southwest Power Pool*, 108 FERC ¶ 61,003 (2004), Delegation Agreements Order at P 396-405, Delegation Agreements Rehearing Order at P 13-20.

¹⁸ North American Electric Reliability Corporation, 117 FERC ¶ 61,091, at P 20, 38-39 (2006) (2007 Business Plan and Budget Order), order on reh'g, 119 FERC ¶ 61,059 (2007).

group, although the trustees must approve any proposed standard before it can be transmitted to NERC for consideration. During the audit period, standards development was limited to work on a regional “fill-in-the-blank” standard.¹⁹

12. In the course of the audit, OE staff issued data requests, conducted analytical work, performed site visits, examined over 1,000 emails, and held many meetings and interviews with SPP’s officials and staff. Subsequently, on September 10, 2008, OE staff sent SPP a draft audit report and gave SPP until September 25, 2008, to respond to the audit findings and recommendations. SPP requested, and OE staff granted, an extension until October 10, 2008, when SPP responded for the first time to the draft Audit Report. Representatives from OE and the Office of Electric Reliability then met with SPP officials and its outside attorneys on October 31, 2008, to discuss the draft audit report and SPP’s response. As a result of this meeting, OE staff sent SPP a revised draft audit report on November 19, 2008, with a December 1, 2008 deadline for SPP’s response. SPP requested more time to respond to the revised draft audit report and OE staff extended the response deadline to December 10, 2008. OE staff engaged in more discussions with SPP during late November and early December. Based on these discussions, OE staff made additional changes based on SPP’s comments and issued SPP a second revised draft audit report on December 3, 2008. SPP responded to the second revised draft audit report by the requested date of December 10, 2008. The SPP Response is also attached to this order.

The Audit Report

13. In the Report, staff determines that during the audit period SPP did not have the strong separation between its RTO and RE functions as required by the Commission. The Report identifies three main areas of concern, discussed more fully below, involving (1) the SPP (RE)’s lack of independence from the SPP (RTO); (2) the need to improve trustees’ oversight of the RE functions to prevent conflicts of interest and to ensure the RE’s independence; and (3) the adequacy of SPP (RE’s) implementation of certain aspects of SPP’s CMEP.

14. The first major concern is whether SPP (RE) operated independently from SPP (RTO) during the audit period. The audit found that: (1) SPP (RTO) management had supervisory control over SPP (RE) employees, including influence over the hiring and

¹⁹ These standards require regional reliability organizations to develop criteria for use by bulk power system users, owners or operators within each region. *See Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242, at P 287, *order on reh’g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

pay of SPP (RE) employees; (2) The Executive Director of Compliance for SPP (RE) participated in meetings of managers of SPP (RTO); (3) SPP (RTO) employees had influence over NERC compliance monitoring and enforcement policies; (4) SPP (RTO) management had the ability to influence the RE's expenditures; and (5) SPP (RTO) employees received confidential RE compliance information. For example,

- SPP (RTO) managers took part in the design of NERC's compliance monitoring and enforcement program in addition to serving as the day-to-day managers for all non-compliance related delegated RE functions. At the same time, one of those managers also supervised the RTO's compliance with NERC standards.²⁰
- RE employees' 2007 performance bonuses were determined as part of the overall SPP bonus process. SPP senior managers commented that the RE trustees' initial performance ratings of RE employees were too high relative to similarly situated RTO employees. In response, the trustees reduced the RE employees' performance ratings, resulting in reduced awards.²¹
- Neither the trustees nor any RE employee can approve an unbudgeted expenditure greater than \$10,000. When expenditures exceed this limit, the expenditure must be authorized by the SPP Chief Financial Officer, Chief Operating Officer, Vice President, President or Board of Directors, depending on the size of the expenditure.²²
- Between May and November 2007, an SPP manager regularly forwarded his notes from meetings of the NERC RE Managers to SPP officers, including SPP's Chief Executive Officer and Chief Operating Officer, who oversees SPP operations and thus shares responsibility for the RTO's compliance with NERC Reliability Standards. Among the subjects covered were interpretation of standards; hearing procedures; settlement principles and procedures; mitigation plans; the NERC Board of Trustees Compliance Committee agenda and compliance violations updates.²³

²⁰ Audit Report at 29.

²¹ Audit Report at 25.

²² Audit Report at 33 and 34.

²³ Audit Report at 39 through 42.

15. The second major concern is the sufficiency during the audit period of the trustees' oversight of the RE operations. The Report finds that the trustees' communications with key employees of SPP (RE) responsible for carrying out day-to-day operations were limited and infrequent. The trustees were unaware that the manager who served as the RE manager had responsibilities for SPP (RTO)'s compliance with the Reliability Standards. The Report states that this lack of awareness of a potential conflict of interest limited the trustees' ability to mitigate conflicts.²⁴

16. The last major concern is SPP (RE)'s implementation of the CMEP. The Report describes concerns with mitigation plans, self-certifications, and audit staffing. For example, in one instance, SPP (RE) should have rejected a mitigation plan by a generator owner because the mitigation plan did not include a detailed schedule and timeline as required by the Commission.²⁵ With respect to a vegetation-related outage mitigation plan, the SPP (RE) failed to gather evidence to determine whether an outage caused by a tree contact resulted from a systematic problem with the registered entity's vegetation management plan.²⁶ With respect to self-certifications, the SPP (RE) extended the deadline for filing of self-certifications by its registered entities of compliance with certain Reliability Standard requirements three times in late 2007 and early 2008.²⁷ Additionally, SPP (RE) employed auditors who may have had a conflict of interest. Three consultants who assisted the RE on audits of Southwestern Public Service and Westar took part in the NERC audit of the SPP coordinator in October 2007.²⁸

SPP Response

17. In its response, SPP states that several findings of the Report imply that employees of SPP acted in an improper manner during the audit period. SPP disputes such implications. Additionally, SPP disputes the Report's characterizations of the trustees. SPP contends that the Report's factual findings regarding the trustees' performance are factually incorrect and beyond the authority of the Commission to address.²⁹

²⁴ Audit Report at 36 through 38.

²⁵ Audit Report at 45.

²⁶ Audit Report at 47.

²⁷ Audit Report at 45 and 46.

²⁸ Audit Report at 48.

²⁹ SPP's Response at 2 and 12. For example, SPP asserts that the "Commission's authority is to regulate the entities over which it has jurisdiction (such as public utilities and REs); it is not to regulate their boards and management." *Id.* at 12.

18. SPP maintains that the actions it and its employees took during the audit period violated neither the SPP Bylaws nor the Delegation Agreement.³⁰ Specifically, in regard to the Report's principal finding concerning the independence of the SPP (RE) operations that SPP did not ensure a "sufficient separation of functions between the RTO and RE," SPP asserts that any finding of a lack of separation should address only the separation of "oversight and operations" between the RTO and RE. In SPP's view, no such lack of separation existed. SPP further argues that SPP (RE)'s dependence on SPP (RTO) for staffing was appropriate as an efficient use of shared services. In addition, SPP disagrees with any conclusion that the use of shared services resulted in insufficient independence between SPP (RTO) and SPP (RE). Similarly, SPP disagrees with any conclusion in the Report that any individuals acted inconsistently with the approved shared services or SPP's Bylaws or Delegation Agreement or in any way unduly influenced the RE or exercised inappropriate control.³¹

19. In regard to the Report's findings regarding the trustees' performance, SPP contends that the findings fail to recognize the appropriate role of trustees and exceed the proper scope of an audit as well as the authority of the Commission. SPP argues that the limited contact between SPP (RE) employees and the trustees cited in the Report is entirely consistent with the proper functioning of a corporate board, which oversees but does not manage an organization. SPP further asserts that the role of the trustees in hiring decisions was appropriate because the trustees fulfilled their specific duty to approve all hiring, and they did so after interviewing the candidates they hired. SPP believes that the extent to which the trustees should consider one or more candidates, or utilize an outside consulting firm, is not within the prerogative of either the Commission or audit staff, but rather resides within the sound business judgment of the trustees.³²

20. SPP's Response did not include any comments regarding the Report's principal findings pertaining to SPP (RE)'s compliance with the CMEP.

Discussion

21. Notwithstanding its disagreement with the findings and conclusions in the Report, SPP has agreed to implement the Report's recommendations. Under these circumstances, while we believe that SPP may have failed to meet the expectations of the Delegation Order and other relevant orders, we will not conclude as a matter of law that SPP violated

³⁰ SPP's Response at 2.

³¹ SPP's Response at 12.

³² SPP's Response at 19.

Commission's orders and regulations during the audit period. In particular, we are pleased that SPP has agreed to hire a Regional Manager and ensure that Manager and the RE Counsel keep the trustees apprised of all RE operations. We will, however, expect SPP to comply with the recommended actions in the Report, and we direct OE staff to report to the Commission any failure of SPP to comply.

22. Because SPP has agreed to implement the Report's recommendations, we conclude that upon implementation of the recommendations, SPP prospectively will satisfy the requirement that its governance structure creates a "very strong" separation between its RTO and RE functions, as Order No. 672 specifies for Regional Entities that include or that are affiliated with an RTO or an ISO. We condition this conclusion on SPP's timely and effective implementation of the Report's recommendations, including the submission of a compliance plan as specified below. In this regard, while we note that the Report does not recommend that SPP amend its bylaws to insert a description of the duties of the Regional Manager or how the Regional Manager will remain independent from SPP (RTO), we suggest that SPP consider whether to so amend its bylaws as an indication that SPP intends to retain the independent Regional Manager position permanently. We remind SPP that failure to create and maintain a very strong separation of the SPP (RE) functions from the SPP (RTO) functions may result in the Commission's reconsideration of SPP as the Regional Entity.³³

23. The Report requires SPP (RE) to design a compliance plan that includes procedures to implement the exception-specific 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, SPP (RE) must make non-public quarterly submissions in Docket No. PA08-2-000 to OE staff detailing SPP (RE)'s progress in implementing the corrective actions set forth in the report until all the corrective 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 compliance plan and continuing until SPP completes all the recommended corrective actions. We direct OE staff to conduct a post-audit site visit when SPP states that it has completed all of the recommendations to ensure that all of the corrective actions taken as a result of implementing the recommendations were properly completed. We also direct OE staff to conduct another audit of SPP (RE) independence from SPP (RTO) in FY 2011.

³³ The Commission conditioned its acceptance of SPP's 2009 budget on the outcome of the PA08-2-000 audit, based upon the Commission's observation that issues it raised about the 2009 budget may relate to topics of the audit. *North American Electric Reliability Corp.*, 125 FERC ¶ 61,056, at P 58 (2008). The Commission will address this matter in a subsequent order.

The Commission orders:

- (A) The attached Report is approved in its entirety without modification.
- (B) SPP is directed to implement the corrective actions recommended in the Report.
- (C) SPP is directed to submit a compliance 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) SPP must make non-public quarterly submissions in Docket No. PA08-02-000 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 compliance plan and continuing until SPP completes all the recommended corrective actions.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

ATTACHMENT A



Federal Energy Regulatory Commission

Audit of Regional Entity Operations at Southwest Power Pool (SPP)

Docket No. PA08-2-000 (RE)

December 22, 2008

Office of Enforcement
Division of Audits

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I. Executive Summary

A. Overview

The Office of Enforcement's (OE) Division of Audits, working with the Office of Electric Reliability's Division of Compliance (OER), has completed an audit of Southwest Power Pool, Inc.'s (SPP, Inc.) Regional Entity (RE) function. The audit determined SPP, Inc.'s compliance with (1) the SPP, Inc. Bylaws, (2) the Delegation Agreement between the North American Electric Reliability Corporation (NERC) and SPP, Inc. and the conditions included in the relevant Commission orders, and (3) other obligations and responsibilities as approved by the Commission. The audit covered the period from May 18, 2007 through August 30, 2008. SPP staff was cooperative in responding to audit staff's data and interview requests.

This audit was intended in part to help the Commission determine whether SPP, Inc.'s governance structure creates a "very strong" separation between its Regional Transmission Organization (RTO) and RE functions as required by the Commission in Order No. 672.¹ Audit staff will issue an audit report on SPP, Inc.'s RTO function in this docket at a later date.

As detailed below, audit staff found that SPP, Inc. did not have an adequate separation between its RTO and RE functions as required by Commission orders. Information gathered through interviews, emails and other records demonstrated that the RE has been heavily dependent on SPP, Inc. for staffing and largely subject to its control. These findings are summarized in Section E below and in full in Part III.

¹ We use the terms "RE" or "RTO" when referring to the functions and the employees performing them. We use the term "SPP, Inc." when referring to the corporation, its Board of Directors and its officers. Because SPP, Inc. and the RE share responsibility for compliance with the NERC delegation agreement and related Commission orders, we use the term "SPP" when we are referring to SPP, Inc. and the RE collectively.

B. Southwest Power Pool Regional Entity (RE)

The Commission approved SPP, Inc. as an RE on April 19, 2007² in the order that, *inter alia*, approved NERC's Delegation Agreement with SPP, Inc. and NERC's Uniform Compliance Monitoring and Enforcement Program (Uniform Compliance Program). The Commission approved NERC's 2008 budget, including the budget and business plan for the RE function, on October 18, 2007.³

Under section 215(e)(4) of the Federal Power Act, the Commission may approve NERC's delegation to REs of authority to propose and to enforce reliability standards. As an RE, SPP oversees 125 registered entities in eight states in the south and southwestern United States. Within SPP's footprint, NERC has delegated to SPP the following major program elements:⁴

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.

During the audit period, the RE staff performed and administered function 3 while RTO staff and other stakeholders served as volunteer participants. Staff shared by the RTO and RE performed three of these functions (5, 6, and 7); shared and RE staff performed function 4; and the RE staff solely performed function 2. Function 1, developing reliability standards, is performed by an SPP stakeholder group. During the audit period, standards development was limited to work on a regional "fill-in-the-blank" standard.

² *North American Electric Reliability Corp.*, 119 FERC ¶ 61,060 (April 19, 2007 Order), order on reh'g, 120 FERC ¶ 61,260 (2007) (*Delegation Agreements Rehearing Order*).

³ *North American Electric Reliability Corp.*, 121 FERC ¶ 61,057 (2007) (*2008 Budget Order*).

⁴ *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).

SPP budgeted \$4.6 million and 12.4 full time equivalent employees (FTEs) for the RE for 2008. The RE currently has five full-time employees, including a legal counsel and four compliance employees, led by the Executive Director for Compliance (Ron Ciesiel). The remaining FTEs represent shared employees who also perform RTO functions.⁵

During 2007, 23 shared employees from SPP, Inc.'s executive, engineering and training functions reported performing services for the RE. Within the engineering group, 14 employees allocated time to the RE, with three employees reporting about half the total time recorded (4.9 FTEs total). Eight people from the RTO's training department reported work for the RE, with four employees accounting for approximately 78% of the total (3.7 FTEs total). One person, SPP, Inc.'s Executive Director for Interregional Affairs (Charles Yeung), charged time to the executive department (0.3 FTEs).

During the first quarter of 2008, 17 employees from the engineering, executive, operations, communications, and training departments (6.7 FTEs) and four full-time RE staffers had their time billed directly to the RE.

The RE also pays the RTO an "adder" of \$110 per hour for all hours reported by the RE staff and the 17 shared employees who had their time billed directly to the RE. The adder is to cover the RE's "indirect" costs – its share of SPP, Inc.'s overhead for costs including payroll and accounts payable processing, human resources and benefits management, accounting, information technology, executive leadership, corporate affairs and communication, office costs and other support services and expenditures. Sixteen employees in those functions reported spending "indirect" time on RE activities in the first quarter.

The RE is scheduled to perform 18 compliance audits in 2008 (excluding a NERC-led audit of the SPP Reliability Coordinator).⁶ Compliance activities constitute nearly 37% of the RE budget for 2008. Training Education (29%); Reliability Assessment (16%); Administrative Services (11%); Reliability Readiness Evaluations (4%); Reliability Standards (3%); and Situation Awareness (0.5%) make up the balance of the RE budget.⁷

⁵ SPP, Inc. has approximately 309 employees.

⁶ See

[ftp://www.nerc.com/pub/sys/all_updl/compliance/Consolidated_Compliance_Audit_Schedule_2008-2009-\(05-19-2008\).pdf](ftp://www.nerc.com/pub/sys/all_updl/compliance/Consolidated_Compliance_Audit_Schedule_2008-2009-(05-19-2008).pdf).

⁷ The 2008 budget for compliance activities included \$160,000 in hearing and meeting costs. To maintain consistency with NERC and the other regions,

A full-time RE employee, Ron Ciesiel, is the day-to-day manager of the compliance enforcement activities. Two shared staff (SPP, Inc. managers), the Vice President for Process Integrity and Chief Administrative Officer (Michael Desselle) and the Executive Director for Interregional Affairs (Charles Yeung), oversaw the day-to-day management of the RE's non-compliance functions.

C. Commission Orders Addressing SPP's Independence

As an RTO, SPP manages transmission in seven of these states.⁸ As such, SPP is an operator of the bulk-power system in addition to serving as an RE. In Order No. 672, the Commission found that serving as both an RE and as an RTO in a region may have an inherent conflict of interest because the entity would be responsible for enforcing its own compliance with NERC's reliability standards. While the Commission did not prohibit an entity from serving in both roles, the Commission emphasized that SPP faced a heavy burden to demonstrate a very strong separation of functions between the RTO and the RE.⁹ In Order No. 672, the Commission said it was concerned that:

an RTO or ISO may have an inherent conflict of interest if it is also a Regional Entity itself. The same institution would operate the Bulk-Power System and be responsible for overseeing its own compliance with Reliability Standards. The comments received reinforce the Commission's opinion that such self-enforcement is extremely difficult to carry out satisfactorily. A system operator/Regional Entity in a single corporation – absent *a very strong separation* between the oversight and operations functions – should not oversee its own compliance with Reliability Standards.^[10] (Emphasis added.)

those costs will be captured in the Legal & Regulatory and Member Forums sections of the 2009 and future years' budgets.

⁸ SPP members serve over 4.5 million customers. SPP's footprint includes 17 balancing authorities, 52,301 miles of transmission lines, and 255,000 square miles. Its footprint includes 451 generating plants with a capacity of 45,672 MW. Coal (43%) and gas (42%) dominate the fuel mix.

⁹ Order No. 672 at P 699.

¹⁰ *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 698.

As a result, the Commission stated, an RTO seeking to become a Regional Entity “will have a heavy burden to show that it meets the statutory criterion that it be independent of the operators of the Bulk-Power System in its region.”¹¹

In the *April 19, 2007 Order* approving SPP’s delegation agreement and its compliance monitoring and enforcement plan, the Commission stated that it was relying on SPP’s assertion that:

the ultimate authority to approve and enforce proposed reliability standards will reside with the SPP Regional Entity trustees, who will operate with a sufficient degree of independence from the SPP RTO. Specifically, SPP asserts that the SPP Regional Entity trustees will be the final arbiter regarding each of the reliability functions and duties delegated to SPP.^[12]

The Commission had some concerns, however, about the RE trustees’ ability to act independently. The Commission stated it was not convinced of:

the ability of the SPP RE trustees to act independently of the RTO in matters relating to their appointment, compensation, the preparation and control of budgets, the separation of personnel, the development of reliability standards and in other matters subject to the oversight and control of the SPP board.^[13]

Similarly, in its *March 21, 2008 Order*, the Commission said it “remain[ed] concerned regarding the adequacy of the separation of functions between the SPP RTO and SPP Regional Entity.”¹⁴ The Commission pointed out that the RE’s organizational chart showed only four RE employees,¹⁵ including the executive director for compliance:

¹¹ *Order No. 672* at P 699.

¹² *April 19, 2007 Order* at P 397.

¹³ *Id.*

¹⁴ *North American Electric Reliability Corp.*, 122 FERC ¶ 61,245 (*March 21, 2008 Order*).

¹⁵ The RE added a fifth full-time staffer in April 2008.

We are concerned whether the full time staff dedicated to Regional Entity functions can support adequate reliability oversight in the SPP region. Further, we are concerned about whether SPP Regional Entity's reliance on shared professional employees, including engineers and attorneys, and potentially management, allows for a strong separation of functions as contemplated by the Commission in Order No. 672.^{16]}

The Commission said it would make a final determination regarding the adequacy of the separation of functions between the RE and RTO after reviewing the results of this audit.¹⁷

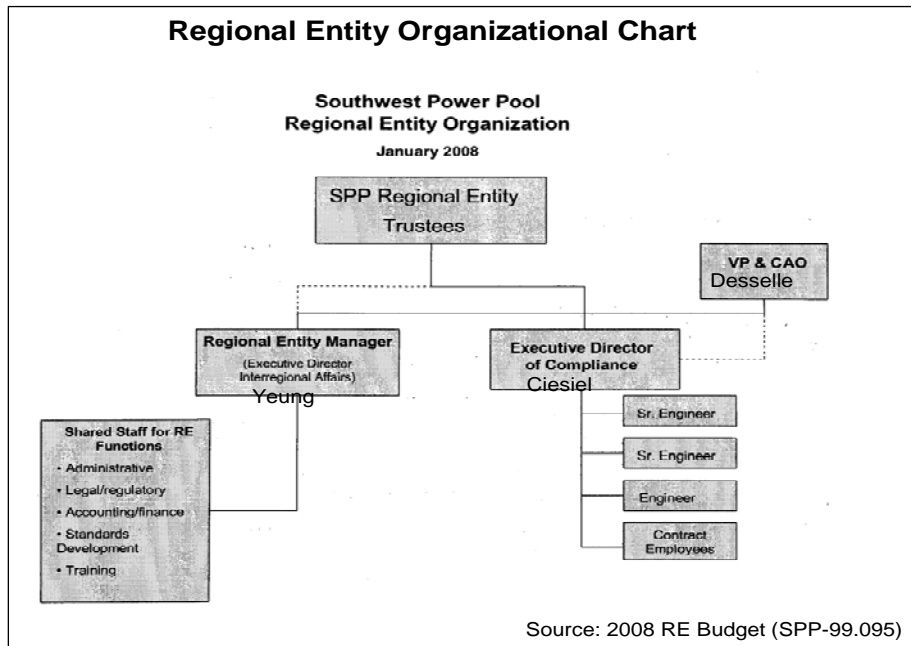
¹⁶ *March 21, Order at P 212.*

¹⁷ *Id.*

D. SPP’s Organizational Structure

Audit staff obtained several organizational charts from SPP representatives in order to understand SPP’s management structure and assess the adequacy of the separations of functions between SPP’s RTO and RE. Figure 1 displays the RE’s organizational structure as portrayed in the RE’s 2008 budget.¹⁸ The chart shows the Executive Director of Compliance (Ron Ciesiel) reporting directly to the RE trustees with a “dotted line” reporting relationship to SPP, Inc.’s Vice President for Process Integrity and Chief Administrative Officer (Michael Desselle). The trustees attend quarterly meetings of the RE and otherwise communicate with RE staff through phone and email. The trustees were envisioned as part-time positions. This chart also shows SPP, Inc.’s Executive Director for Interregional Affairs (Charles Yeung) serving as Regional Entity Manager, with responsibilities for shared staff for RE functions. Mr. Yeung reports directly to Mr. Desselle. NERC officials describe the Regional Entity Manager as the primary contact between NERC and the RE, with responsibility for administering the RE’s programs under the Delegation Agreement.¹⁹

Figure 1

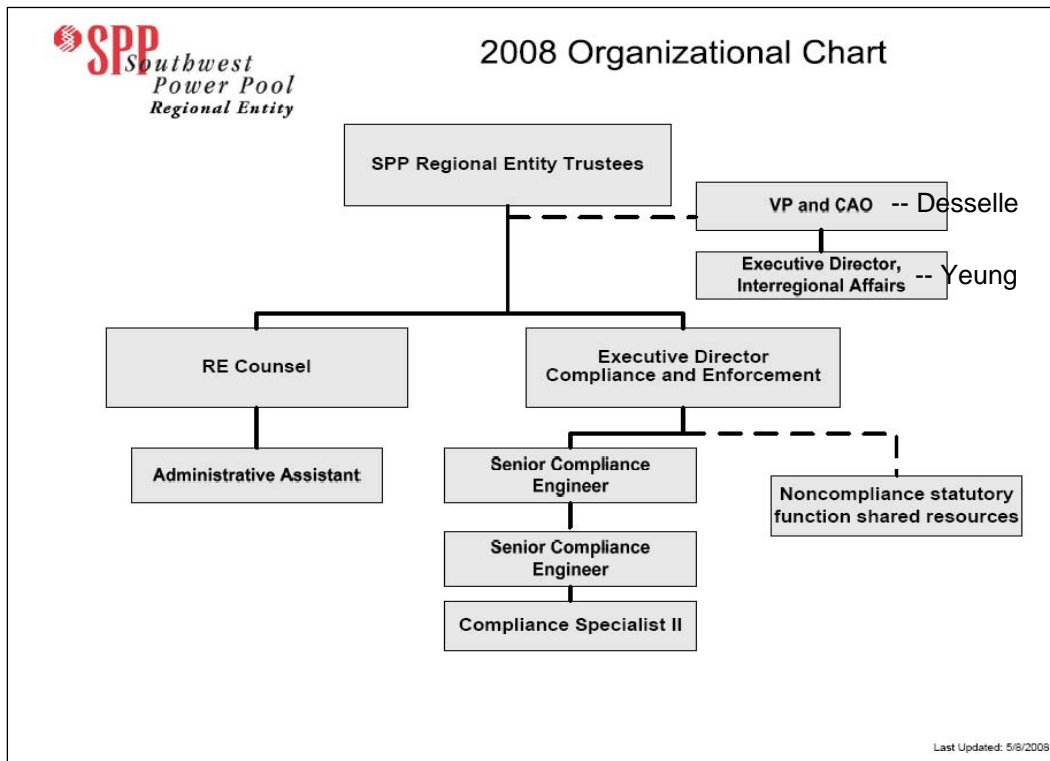


¹⁸ Names were added below titles for clarity.

¹⁹ Conference call with NERC officials, March 13, 2008.

Figure 2 represents a revised RE organizational chart currently posted on the SPP, Inc. website.²⁰ This chart adds a position for the RE legal counsel (Alison Hayes) and eliminates the “Regional Manager” title. Mr. Desselle told audit staff that he and Mr. Yeung share the duties of the Regional Manager but that they no longer use the title. However, as of July 1, 2008, NERC’s website continued to list Mr. Yeung as the Regional Entity Manager.²¹

Figure 2



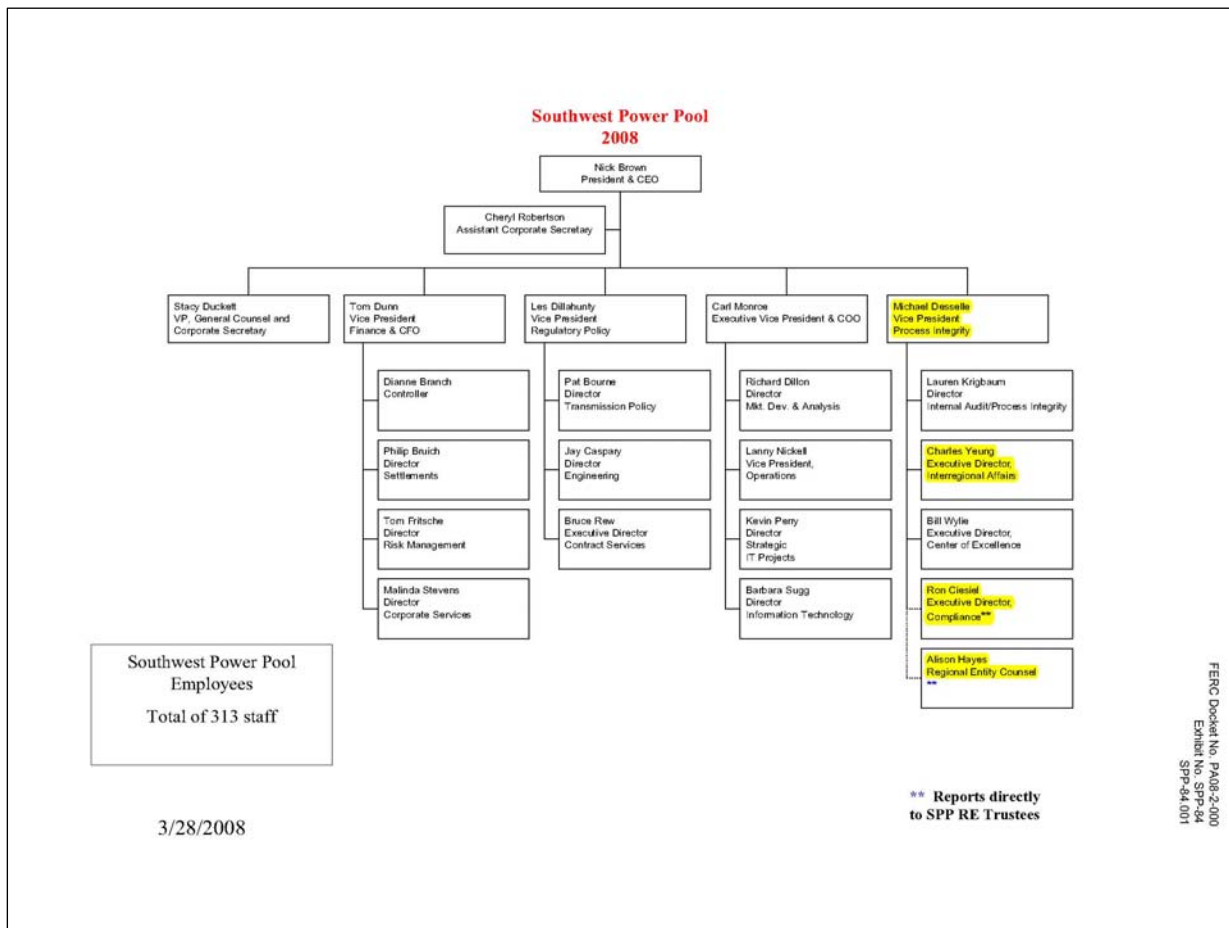
²⁰ Minutes of the January 30, 2008 RE Trustees meeting list as an Action Item: “Revise RE organizational chart to reflect a dotted line from Ron to Noncompliance Statutory Function Shared Resources and make sure line is dotted between RE Trustees and Michael and Charles. Put chart on website.” The minutes do not include any further discussion about the rationale for this new organizational chart.

²¹ http://www.nerc.com/regional/regional_managers.html

Both Messrs. Desselle and Yeung are managers for SPP, Inc. (See Figure 3 below, with cells for Ms. Hayes and Messrs. Desselle, Yeung and Ciesiel highlighted.) As SPP, Inc.’s Vice President for Process Integrity and Chief Administrative Officer, Mr. Desselle oversees the training, project management, and customer relations functions as well as its new Center for Excellence and internal audit function. He also oversees RTO standards compliance, including those standards on reliability. Mr. Desselle estimated that he spent 10 to 20 percent of his time on RE matters in 2007. He did not formally track his hours in 2007.²²

Figure 3

SPP, Inc. Officers & Direct Reports



²² SPP, Inc. CEO Nick Brown is the official charged with approving Mr. Desselle’s time.

Mr. Yeung charged 31% of his time to the RE from April through December 2007. Mr. Yeung, who generally works from his home in Houston, worked on the RE budget and participated in meetings with other Regional Entity managers to discuss delegation agreement implementation issues. An electrical engineer and MBA, Mr. Yeung also coordinates the RTO's comments on proposed reliability and North American Energy Standards Board standards.

The RE's training function is primarily performed by shared RTO employees. Eight people from the RTO's training department reported work for the RE in 2007. The RE's reliability standards development function is performed by SPP stakeholder groups based on technical expertise. Work on the only reliability standard in development has been led by the System Protection and Control Working Group (SPCWG) of the RTO's Market Operations Committee (MOPC), with the assistance of Mak Nagle, the RTO's Manager of Technical Studies and Modeling. -As secretary of the SPCWG, Mr. Nagle managed logistical issues and took minutes of the meetings at which this standard was discussed.

Audit staff notes that the other seven regional entities employ full-time regional managers. By comparison, the SPP RE's manager function is currently a half-time position. For the first quarter of 2008, Messrs. Desselle and Yeung charged 16% and 33% of their time, respectively, to the RE.

Prior to SPP, Inc.'s designation as a Regional Entity in April 2007, the RTO's function charged with its compliance with reliability standards reported to the SPP, Inc.'s Board of Director's Compliance Committee with "dotted line reporting" to Mr. Desselle. It was headed by Ron Ciesiel. When the RE was established and Mr. Ciesiel was appointed the RE's Executive Director of Compliance, David Hodges took Mr. Ciesiel's responsibility for ensuring the RTO's compliance with NERC reliability standards. (SPP informed audit staff that Mr. Hodges' duties extend beyond those duties previously performed by Mr. Ciesiel. Mr. Hodges is responsible for managing the "coordination, implementation and facilitation of compliance plans, policies, procedures and software tracking systems" to ensure SPP's compliance with reliability standards, commercial business practice standards, regional criteria and tariff provisions.) In that role, Mr. Hodges reports directly to Mr. Desselle (See organizational charts, Figures 4-7, in Appendix). SPP, Inc. is registered with NERC as a Reliability Coordinator, Transmission Service Provider, Transmission Planner, Reserve Sharing Group and Planning Authority.²³

²³ Compliance Audit Report, Southwest Power Pool Reliability

E. Summary of Compliance Findings

Audit staff found that SPP, Inc. has not had a “strong” separation between its RTO and RE functions as required by Commission orders. Information gathered through interviews, emails and other records demonstrated that the RE was heavily dependent on the RTO for staffing and subject to its control.

Independence of RE operations

As discussed in the Findings and Recommendations section below, Messrs. Desselle and Yeung took part in the design of NERC’s compliance monitoring and enforcement program in addition to serving as the day-to-day managers for all non-compliance related delegated RE functions. In addition, Mr. Desselle had responsibility for the RTO’s compliance with NERC standards and authority over the RE responsible for enforcing the standard. Because of this dual responsibility, a very strong separation did not exist between the RTO and RE functions. Specific examples of the lack of separation between RTO and RE include the following:

- **RTO management had supervisory control over RE employees, including influence over the hiring and pay of RE employees:** RE employees’ 2007 performance bonuses were determined as part of the overall SPP, Inc. bonus process. SPP, Inc. senior managers commented that the RE trustees’ initial performance ratings of RE employees were too high relative to similarly situated RTO employees. In response, the RE trustees reduced the RE employees’ performance ratings, resulting in reduced awards.

The RE Executive Director of Compliance, Ron Ciesiel, participated in meetings of managers of SPP, Inc.: The RE Executive Director of Compliance participates as part of the SPP, Inc. management team by attending numerous meetings with SPP, Inc. Also, RE employees attended many meetings with RTO employees.

- **RTO employees had influence over NERC compliance monitoring and enforcement policies:** Mr. Desselle and Mr. Yeung were part of e-mail chains that discussed a wide range of compliance policies and issues,

Coordinator, North American Electric Reliability Corp., Nov. 12, 2007.

including the development of NERC's Compliance Monitoring and Enforcement Plan, NERC guidance on compliance violation investigations, compliance violation hearing procedures, compliance violation settlement guidelines, and the audit of the SPP Reliability Coordinator's compliance with reliability standards.

- **RTO management had the ability to influence the RE's expenditures:** Neither the RE trustees nor any RE employee can approve an unbudgeted expenditure greater than \$10,000. When expenditures exceed this limit, the expenditure must be authorized by the SPP, Inc. Chief Financial Officer, Chief Operating Officer, Vice President, President or Board of Directors depending on the size of the expenditure.
- **RTO employees have received confidential RE compliance information:** Between May and November 2007, Mr. Yeung regularly forwarded his notes from meetings of the NERC RE Managers meetings to Mr. Desselle and other SPP, Inc. officers, including SPP, Inc. Chief Executive Officer Nick Brown. Among the officers receiving this information was Chief Operating Officer Carl Monroe, who oversees SPP, Inc. operations and thus shares responsibility with Mr. Hodges and Mr. Desselle for the RTO's compliance with NERC Reliability Standards. Among the subjects covered were interpretation of standards; hearing procedures; settlement principles and procedures; mitigation plans; the NERC Board of Trustees Compliance Committee agenda and compliance violations updates.

Regional Entity Board of Trustees

To evaluate the RE's independence, audit staff interviewed the RE trustees and SPP staff and reviewed more than 1,000 emails. Based on this evaluation, audit staff believes the trustees' oversight of the RE functions could be improved to prevent conflicts of interest and to further ensure the RE's independence. Audit staff reached this determination based on the following information gathered during the course of this audit.

The trustees' communications with Mr. Ciesiel and Ms. Hayes were infrequent and limited as follows:

- The trustees received an email report from Mr. Ciesiel and Ms. Hayes once or twice monthly and have little day-to-day involvement with the RE staff.²⁴
- The chairman of the RE trustees, John Meyer, said he spoke to Mr. Ciesiel and Ms. Hayes about once a month each.
- Trustee David Christiano said he spoke to Mr. Ciesiel and Ms. Hayes with similar frequency.
- Trustee Gerry Burrows said he “very seldom” talks to Mr. Ciesiel or Ms. Hayes outside of meetings.

The trustees have limited contact with Mr. Ciesiel regarding reliability penalties because they choose only to require Mr. Ciesiel to provide them prior review of Notices of Alleged Violation and Penalty Letters for cases in which the RE is recommending penalties in excess of \$150,000. To date, SPP has not assessed a penalty in excess of the \$150,000 threshold.

During interviews with audit staff, the trustees said they were unaware of Mr. Desselle’s responsibilities for the RTO’s compliance with NERC rules. This lack of awareness of a potential conflict of interest limits the RE trustees’ ability to mitigate the conflict.

In addition, the RE trustees did not meet with RE staff often enough to assure that the RE operations were conducted with a sufficient amount of independence.

While we understand that the trustees are directors and spend only a portion of their time overseeing the RE function, we believe it would be beneficial if the trustees were more actively involved in overseeing the RE operations to ensure the RE independence and adequate separation of RTO and RE operations. Hiring a full-time Regional Manager to carry out the day to day operations of the RE will help the trustees perform its oversight responsibilities. This would better ensure that the trustees have ultimate control of all delegated functions. Moreover, the Regional Manager and the RE counsel should keep the trustees abreast of matters affecting the RE operations. As explained below, we believe trustees that are better informed about the RE operations and the hiring of a full-time RE manager reporting directly to them substantially address our concerns in this area.

²⁴ RE staff issued 11 reports to the trustees in the nine months between August 31, 2007 and May 30, 2008.

Compliance with the Compliance Monitoring and Enforcement Plan

To review the RE's compliance with the CMEP, audit staff reviewed procedures and processes for event analyses and mitigation plans and sampled documentation to determine RE's involvement and oversight of self-certifications, self-reports, and mitigation plans. Based on this review, audit staff has several concerns about RE's implementation of the CMEP:

- **Review of Mitigation Plans:** Audit staff sampled and reviewed mitigation plans from five registered entities. We identified one instance in which the RE should have rejected a mitigation plan by a generator owner because the mitigation plan did not include a detailed schedule and timeline as required by the Commission.²⁵ In addition, the generator owner subsequently updated its mitigation plans and included violations of standards relevant to the generation operator (GOP). The RE should have rejected this update and required the registered entity to file separate mitigation plans for the additional violations along with a detailed schedule and timeline. The RE also should have required the registered entity to register as a GOP upon its original mitigation plan submittal. These new mitigation plans would have been applied to the now mandatory and enforceable reliability standards and subject to sanctions and penalties.
- **Self-Certification:** The RE extended the deadline for filing of self-certification of its registered entities three times in late 2007 and early 2008. Despite the repeated extensions, the RTO was not aware of the self-certification deadline until after it was questioned by audit staff during a site visit.
- **Vegetation-Related Outage Mitigation Plan:** The RE failed to gather evidence to determine whether an outage caused by a tree contact resulted from a systematic problem with the registered entity's vegetation management plan.
- **Audit Staffing:** The RE employed auditors who may have had a conflict of interest. Three consultants who assisted the RE on its SPS and Westar audits also took part in the NERC audit of the SPP Reliability Coordinator in October 2007. Audit staff is concerned that consultants employed by the

²⁵ *North American Electric Reliability Corp.*, 119 FERC ¶ 61,274 at P 5 (2007).

RE may have a conflict of interest in auditing the SPP Reliability Coordinator.

F. Recommendations

To ensure the RE's independence and adequate separation of the RTO and reliability functions, audit staff recommends that the RE take the following actions:

- Hire a full-time RE manager to oversee all delegated functions of the RE and serve as its primary representative to NERC. The RE trustees should use a process independent of SPP, Inc. management to hire a full-time RE manager. (SPP, Inc. human resources staff may assist the RE in the process);
- Eliminate all reporting relationships between RE employees and RTO employees. This includes administrative reporting (e.g., approving time off and expense reports) as well as reporting related to performance evaluations. In addition, the RE manager must limit RE employees' attendance at SPP, Inc. meetings to those that do not present potential conflicts, specifically those designed to address broad corporate administrative matters and career development;
- Administer RE staff performance awards independent of RTO management and staff. The RE trustees must have full control over determining the bonuses for RE employees, provided that this shall not preclude them from considering the recommendations of the SPP Human Resources Committee concerning the size of the bonus pool;
- Establish procedures giving the new RE Manager authority to approve the RE trustees' expenses;
- Establish procedures to ensure the RE is free to offer employment to any candidate without consultation with or approval of the RTO. For candidates currently employed by SPP, Inc. the RE may cooperate with the RTO on the timing of the employee's transition to minimize disruption to RTO operations;
- Review the RE engineering resource requirements and consider hiring additional engineering staff to perform the delegated functions of the RE;

- Ensure that RTO managers have no involvement in matters relating to NERC and SPP RE's compliance monitoring and enforcement policies unless involvement relates to public matters pertaining to RE and NERC processes available to interested parties including RTOs;
- Appoint an RE staff member to represent SPP on NERC's Reliability Assessment Subcommittee and any other committee or subcommittee whose authority includes RE statutory functions;
- Implement processes and procedures to ensure the RE has full authority over its budgeted spending, including RE employees' salaries and bonuses;
- Implement a process to allow the RE Manager and RE trustees to approve unbudgeted expenses at the same levels that an RTO officer may approve such expense. If the RE seeks to make an unbudgeted expense that exceeds these corporate limits, the RE shall seek Commission approval for a change in its budget;
- Provide that the RE manager may authorize withdrawals from the RE bank account consistent with the RE budget and eliminate SPP, Inc. management's authority to review or authorize withdrawals from the RE bank account;
- Have the ability to determine the amount of funds available to the RE at anytime upon request and develop a process for addressing discrepancies resulting from an audit, bank account reconciliation, or internal reviews of the RE segregated funds;
- Develop procedures to ensure that the independent RE Manager approves shared employees' allocation of costs to the RE;
- Ensure that the RE reimburse the RTO for the RE trustees' 2007 travel expenses;
- Provide a detailed written response explaining how the RE manager and RE counsel plan to keep the trustees better informed of important matters affecting the RE operations;
- Develop procedures to ensure that RTO managers and employees are prevented from receiving confidential compliance information and that

RTO employees are permitted access to RE offices only when necessary to perform shared RE functions and when accompanied by RE staff. These procedures should include a non-disclosure agreement that shared staff must sign pledging not to reveal confidential RE information;

- Require detailed completion schedules for all mitigation plans;
- Work with NERC and the other REs to develop a written policy on extending self-certification deadlines;
- Develop procedures to ensure the RE staff obtain corroborating evidence to verify a registered entity's compliance following a self-report; and
- Ensure that NERC performs all audits of SPP, Inc.'s registered entity functions (Reliability Coordinator, Transmission Service Provider, Transmission Planner, Reserve Sharing Group and Planning Authority), including all facets of these audits, from audit commencement and pre-audit survey to final audit report.

G. Compliance and Implementation of Recommendations

The RE 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, the RE must make non-public quarterly submissions in Docket No. PA08-2-000 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 SPP completes all the recommended corrective actions.

II. Introduction

A. Objectives

The Division of Audits of the Office of Enforcement (OE) of the Federal Energy Regulatory Commission (FERC), working with FERC's Division of Compliance in OER, commenced an audit of Southwest Power Pool, Inc. to review SPP's performance:

- as a transmission provider and operator of a real-time balancing market as an RTO; and
- as an RE, delegated by the North American Electric Reliability Corporation, to enforce FERC-approved mandatory electric reliability standards.

SPP has members in eight states: Arkansas, Kansas, Louisiana, Mississippi, Missouri, New Mexico, Oklahoma, and Texas. As an RTO, SPP manages transmission in seven of these states. As such, SPP is an operator of the bulk-power system in addition to serving as an RE. In Order No. 672, the Commission found that serving as both an RE and as an RTO in a region may create an inherent conflict of interest because the entity would be responsible for enforcing its own compliance with NERC's reliability standards. While the Commission did not prohibit an entity from serving in both roles, the Commission emphasized that SPP faced a heavy burden to demonstrate a very strong separation of functions between the RTO and the RE.²⁶

B. Scope and Methodology

As noted above, the Division of Audits is issuing this report in order to provide timely information to the Commission on the separation between SPP's RTO and RE functions; the Division of Audits will issue a subsequent report on the RTO operations.

The procedures audit staff performed to evaluate the adequacy of SPP's separation of functions between its RTO and RE operations included the following:

²⁶ Order No. 672 at P 699.

- To familiarize itself with SPP's operations, audit staff reviewed publicly-available materials, FERC's E-Library for company filings, Commission orders and formal complaints, the Enforcement Hotline for complaints made against the company, and local newspapers, trade and academic press to identify significant developments and occurrences that arose during the audit period.
- Audit staff conducted its initial visit to SPP, Inc. headquarters on October 29-31, 2007, during which it participated in NERC's compliance audit of SPP's reliability coordinator function. On our second site visit, February 4-7, 2008, we interviewed RTO and RE management and staff to understand their job functions. Those interviewed included the:
 - Vice President, Process Integrity
 - Vice President and General Counsel
 - Executive Director, Interregional Affairs
 - Executive Director for Compliance (RE)
 - RE Counsel
 - Director, Market Development & Analysis
 - Manager, Reliability Coordination
 - Director of Operations
 - Standards Compliance Manager
 - Director of Transmission Policy
 - Manager Market Operations
 - Director of Settlements
 - Director of Engineering
- In April 2008, audit staff attended a meeting of the SPP, Inc. Members and Board of Directors and a meeting of the RE trustees. We also interviewed each of the RE trustees.
- Audit staff issued numerous data requests and reviewed more than 1,000 emails and other records to test SPP's compliance with Commission orders and statutes. We also conducted numerous phone conferences to clarify data responses and seek additional information.

Specifically audit staff did the following:

Standards setting process, including interaction with market function

- Reviewed SPP’s Standards Development Process Manual.²⁷ The manual allows any entity with a “direct and material interest in the Bulk Power System” to request that a standard be developed, modified or withdrawn and to participate on a standards drafting team, provide comments on proposed standards and vote on a proposed standard. SPP, Inc.’s MOPC will assign standards to an SPP Working Group or Task Force to serve as the Standards Development Team. The process also calls for advisory votes by the SPP, Inc. Board of Directors and Members Committee. Ultimate authority to submit a proposed standard to NERC for approval resides with the RE trustees.
- Reviewed committee meeting minutes and identified participants and affiliations involved with standard development to ensure that all registered entities were aware of standards in development.
- Reviewed the process of the one standard currently in development (Under-frequency Load Shedding, PRC-00X-SPP-01). NERC designated PRC-006 (Development and Documentation of Regional UFLS programs) as one of the regional “fill-in-the-blank” standards. The standard was submitted to the MOPC by the SPCWG. MOPC referred the standard back to the SPCWG for scoping and drafting. Notice of the proposal was posted on SPP’s website on October 29, 2007. The RE trustees were notified prior to their October 31, 2007 meeting, as required by the standards development manual. The SPCWG reviewed a draft of the standard in a conference call on May 6, 2008. Minutes of the meeting indicate the group is awaiting guidance from NERC’s proposed continent-wide UFLS standard.

Accounting for shared costs

- Interviewed both RTO and RE employees, specifically those involved in shared services and governance responsibilities.
- Observed and tested processes and methodology for recording and allocating shared costs between the RE and RTO, including calculations of direct and indirect rates applied to shared services.

²⁷ Southwest Power Pool Regional Entity Standards Development Process Manual, October 2, 2007.

- Reviewed SPP, Inc. expenditure policies.

Independence / RE separation of function

- Reviewed RE and RTO processes and procedures related to statutory activities.
- Reviewed more than 1,000 emails to and from RE staff and RTO employees to test independence.
- Toured facilities used by the RE.

Event analyses

- Sampled documentation of event analyses to review the RE's involvement.
- Reviewed procedures for participation in event analyses.

RE compliance with CMEP

- Reviewed processes for monitoring mitigation plans.
- Reviewed a sample of mitigation plans from registered entities to document the RE's oversight and monitoring.
- Reviewed self-certifications and self-reports and mitigation plans for a sample of five registered entities.

III. Findings and Recommendations

A. SPP's Regional Entity Has Operated Under the Control of the SPP RTO

Audit staff found that SPP, Inc. did not ensure a strong separation of functions between the RTO and RE. Information gathered through interviews, emails and other records demonstrated that the RE was heavily dependent on SPP, Inc.'s staffing and subject to its managerial control. As such, the RE did not operate with a sufficient amount of independence to meet the statutory criterion that it be independent of the operators of the bulk-power system in its region.²⁸ The RE trustees' oversight of the RE functions could be improved to prevent actual and potential conflict of interests and to further ensure the RE's independence.

The Commission expressed its concern in the *March 21, 2008 Order* that SPP had not created a strong separation between its RE and RTO functions.²⁹ Audit staff believes that two SPP, Inc. managers with RTO responsibilities, the Vice President for Process Integrity (Michael Desselle) and the Executive Director of Interregional Affairs (Charles Yeung), exercised significant influence over RE matters, as detailed below.

SPP RE is Integrated into SPP, Inc. for Managerial and Administrative Purposes

Audit staff has the following concerns with RTO managers' roles and responsibilities pertaining to RE operations:

- *RTO management exercised supervisory control over RE employees, including influence over the hiring of and pay for RE employees. RTO managers were involved in many RE management matters such as hiring decisions, salary determinations and bonuses for performance. RTO managers also approved RE employees' time off and expense reports and informed them as to which NERC meetings the RE employees should attend.*

²⁸ Sections 215(c)(2)(A) and 215(e)(4)(B) of the Federal Power Act, 16 U.S.C. §§824o(c)(2)(A) and 824o(e)(4)(B) (2006).

²⁹ *March 21, 2008 Order* at P 212.

- *The RE Executive Director of Compliance functioned as a manager of SPP, Inc.* The RE Executive Director of Compliance participated as part of the RTO management team by attending numerous meetings with RTO managers. Also, RE employees attended many meetings with RTO employees.

Based on the frequent involvement of RTO managers with RE functions and the RE employees' involvement in SPP, Inc. meetings and programs, audit staff believes that SPP, Inc. did not demonstrate a sufficient separation of functions between its RTO and RE operations.

Pertinent Guidance

The Commission's acceptance of SPP's delegation agreement was based, in part, on SPP's representations that the SPP RE would be managed by an independent board of trustees. NERC asserted in its initial delegation agreement filing that "SPP has established a strong separation of functions between its compliance monitoring and enforcement activities and its operational activities."³⁰ In addition, NERC and SPP indicated in NERC's compliance filing to the *April 19, 2007 Order* that "as provided in the SPP Bylaws, the Executive Director of Compliance, who is responsible for the Compliance Monitoring and Enforcement Program, reports directly to the Regional Entity trustees who have responsibility for employment, evaluation, and compensation."³¹

Background

RTO Management Exercised Supervisory Control over RE Employees

Audit staff interviewed Mr. Desselle to inquire about his RE responsibilities. During these interviews, Mr. Desselle said he does not supervise Mr. Ciesiel; rather the "dotted line" on the organizational chart (see Figure 1, above) reflects his role as Mr. Ciesiel's conduit for obtaining SPP resources (i.e., shared staff; computers; office space; job descriptions; expense reimbursements). Mr. Ciesiel, in turn, described Mr. Desselle as his interface for obtaining shared services from the RTO or help on implementing policies. Mr. Ciesiel said he took

³⁰ NERC initial delegation agreement filing addressing Docket No. RR07-6-000 at page 28.

³¹ NERC Compliance filing addressing Docket No. RR07-6-000, October 30, 2007 at page 102.

orders from Mr. Desselle only in regard to SPP, Inc. general policies such as expenses, credit card use, holidays and performance appraisals.

Based on its review of documents and interviews of SPP staff, however, audit staff believes that Mr. Desselle and Mr. Yeung – as Mr. Desselle’s co-Regional Entity Manager – frequently participated in decisions regarding RE compliance matters.

During the launch of the RE, Mr. Desselle and SPP, Inc. General Counsel Stacy Duckett had significant roles in hiring Mr. Ciesiel and Ms. Hayes and in setting Mr. Ciesiel’s starting salary. Mr. Ciesiel collaborated with Mr. Desselle in writing his own job description. The RE trustees hired Mr. Ciesiel at their first meeting, after receiving a memo from Ms. Duckett, who wrote: “The Trustees must act to hire the Director (Ron Ciesiel).” The trustees hired Mr. Ciesiel without posting the position or considering other candidates. SPP asserted to audit staff that the memo was simply “an administrative reminder” that the trustees needed to select an Executive Director.

Before Mr. Ciesiel was appointed to the RE position, Mr. Desselle approved raising Mr. Ciesiel’s annual salary effective January 1, 2007. Mr. Desselle also approved a significant performance bonus for Mr. Ciesiel on February 28, 2007, before Mr. Ciesiel was appointed to the RE position. After Mr. Ciesiel’s appointment to the RE post Mr. Desselle recommended the RE trustees adopt a recommendation by a compensation consultant that Mr. Ciesiel’s pay be raised a considerable amount effective August 1, 2007.

Ms. Hayes, a former administrative law judge for the Arkansas Department of Human Services, began work as the RE counsel in October 2007. She replaced Ms. Duckett, the SPP, Inc. general counsel, who had served in an interim capacity. Ms. Duckett wrote the job description for the RE general counsel position with input from Mr. Yeung and Mr. Desselle. At the trustees’ request, Ms. Duckett and Mr. Desselle interviewed the initial respondents to the job posting and selected three of the candidates for follow-up interviews by the trustees. The trustees selected Ms. Hayes from the three finalists.

Mr. Desselle and SPP, Inc. senior management played an integral role in the process that awarded Ms. Hayes, Mr. Ciesiel and Mr. Ciesiel’s two direct reports performance awards for their work in 2007. The awards the RE employees received were drawn from the same “pool” of bonus money as that used for the RTO staff.

Mr. Desselle informed the trustees at an executive session at the January 2008 meeting of SPP, Inc.'s process for awarding SPP employees performance compensation for their work in 2007: the Human Resources Committee and the Board of Directors identify successes and failures for the previous calendar year to be used in considering each individual's contributions to the organization. Also considered is employee performance compared to his or her job expectations. The process results in a ranking (from -10 to +10) that is one of the multipliers, along with pay grade, in determining the payout amount. Among the successes identified by the Human Resources Committee for 2007 was the successful startup of RE functions.

Mr. Ciesiel prepared recommended rankings for his two direct reports. Mr. Desselle prepared recommended rankings for Mr. Ciesiel and Ms. Hayes. On February 8, 2008, Mr. Desselle discussed the recommendations in executive session with the trustees, who approved the rankings per the recommendations. Mr. Desselle forwarded the RE staff rankings on or about February 9, 2008 to SPP, Inc.'s Chief Operating Officer, who compiled the recommendations for all of SPP.

Mr. Desselle said he discussed the trustees' approved awards for RE employees with the other SPP, Inc. officers and found they were "extremely high" relative to those recommended by RTO managers for RTO employees. On February 13, 2008, Mr. Desselle and SPP, Inc. President and Chief Executive Officer Nick Brown discussed the performance award process with RE Trustees Chairman John Meyer and advised Mr. Meyer that the RE's rankings were high relative to the rest of SPP. Mr. Desselle said he and Mr. Brown explained to Mr. Meyer that because the RE and RTO bonuses were drawn from a common pool of funds, the process was a "zero-sum game," meaning more money for RE staff meant less available for RTO employees.

Later that day, Mr. Desselle had an executive session conference call with Mr. Meyer and the other trustees, at which Mr. Desselle repeated the message he and Mr. Brown had delivered to Mr. Meyer. Mr. Desselle said although there was some "pushback" from the trustees, they ultimately agreed to lower their rankings.³² The trustees' revised rankings were later approved by the SPP, Inc. officers and the RE employees received their awards in February 2008.

³² Mr. Desselle said there are no records of the trustees' revised rankings. Mr. Desselle said he delivered the new recommendations orally to Carl Monroe, who changed them directly on a spreadsheet. According to Mr. Desselle, Mr. Monroe destroyed the ranking records after the resulting bonus amounts were sent

The RE Executive Director of Compliance Participated in Meetings of Managers of SPP, Inc.

Despite the Commission's requirement for strong separation between RTO operations and compliance monitoring and enforcement, Mr. Ciesiel was treated like any other RTO manager, and the RE staff was treated as RTO staff. Although SPP's organizational charts show only a dotted line between Mr. Ciesiel and Mr. Desselle, Mr. Ciesiel acted as a direct report to Mr. Desselle. Indeed, in an email discussing budget submissions in July 2007, Mr. Desselle identified Mr. Ciesiel among his direct reports. See Figure 8, Appendix. Mr. Desselle approved vacation requests and expense reimbursements for Mr. Ciesiel and other RE employees. Mr. Ciesiel regularly attended SPP managers meetings.

Mr. Ciesiel told audit staff that he has attended the following RTO meetings regularly:

- SPP's monthly managers meeting with about 40 other SPP managers;³³
- SPP employee staff meetings (held after each board meeting or as called by CEO Nick Brown);
- director of engineers meetings -- meetings of the six SPP managers who supervise engineers, including director of engineering; vice president of operations; director of market development and analysis; executive director, contract services, and director, transmission policy; and
- general SPP budget meetings.

Mr. Ciesiel said he missed SPP's annual Leadership Conference on May 7, 2008 -- an all-day affair featuring lectures on management and leadership -- but that the rest of his RE staff attended.

Audit staff is particularly concerned with Mr. Desselle's administrative oversight of Mr. Ciesiel and Ms. Hayes, the RE Counsel. This included approving Mr. Ciesiel's and Ms. Hayes' expense reports and vacation requests. E-mails show Ms. Hayes asking Mr. Desselle or Ms. Duckett for permission to leave the office to run errands and to work from home. Mr. Ciesiel's deference to Mr. Desselle was such that he requested Mr. Desselle's permission before adding a

to payroll for payment.

³³ The meetings included discussions on leadership; the SPP budget; performance compensation and the mandatory reliability standards that took effect June 18, 2007.

modified form of the SPP logo³⁴ to the SPP Standards Development Process Manual. Mr. Desselle and Mr. Yeung gave orders to Mr. Ciesiel and Ms. Hayes on exclusively RE compliance matters, including deciding which NERC committee meetings they should attend.³⁵ Audit staff is concerned that the degree of administrative oversight exhibited by RTO managers could lead to RE staff showing undue deference to these same RTO managers regarding the compliance of the RTO to reliability standards.

Mr. Desselle also reviewed and approved the trustees' expense reports. Before the trustees' interviews with audit staff, Mr. Desselle and Ms. Duckett briefed the trustees and the RE counsel.

Another example of the lack of separation of functions came when Mr. Ciesiel asked the SPP, Inc. human resources department to prepare a job offer for an RTO staffer Mr. Ciesiel wanted to hire as a lead compliance specialist. The candidate then worked in the training department under one of Mr. Desselle's direct reports. Human resources forwarded the request to Mr. Desselle for his approval. While Mr. Desselle approved the hiring in this instance, audit staff believes it is inappropriate for an RTO manager to have the authority to overrule RE hiring decisions.

As a result of the repeated involvement of RTO management in RE compliance matters as described above, audit staff believes the RE did not have sufficient, management and personnel, separation from RTO operations.

³⁴ The standard SPP logo with the words "Regional Entity" underneath.

³⁵ On March 4, 2008, Mr. Yeung sent an email to Ms. Hayes and Mr. Ciesiel telling them: "Alison or Ron or both, please make plans to participate" in a NERC Board of Trustees Compliance Committee conference call the following week. On January 10, 2008, Ms. Hayes sent Mr. Desselle an email regarding a NERC meeting in Phoenix: "You sent me the link to register for this meeting. I want to make sure that you want me to attend before I make all of the arrangements. If so, when do I need to arrive?" Mr. Desselle responded: "I don't think you need to be at the Regional Manager's meeting Sunday at 6 PM on Sunday evening, but the compliance committee usually meets first thing in the morning on Monday, so give yourself enough time to leisurely arrive sometime Sunday evening."

Recommendations

We recommend the RE:

1. Hire a full-time RE manager to oversee all delegated functions of the RE and serve as its primary representative to NERC. The RE trustees should use a process independent of SPP, Inc. management to hire a full-time RE manager. (SPP, Inc. human resources staff may assist the RE in the process);
2. Eliminate all reporting relationships between RE employees and RTO employees. This includes administrative reporting (*e.g.*, approving time off and expense reports) as well as reporting related to performance evaluations. In addition, the RE manager must limit RE employees' attendance at SPP, Inc. meetings to those that do not present potential conflicts, specifically those designed to address broad corporate administrative matters and career development;
3. Administer RE staff performance awards independent of RTO management and staff. The RE trustees must have full control over determining the bonuses for RE employees, provided that this shall not preclude them from considering the recommendations of the SPP Human Resources Committee concerning the size of the bonus pool;
4. Establish procedures giving the new RE Manager authority to approve the RE trustees' expenses;
5. Establish procedures to ensure the RE is free to offer employment to any candidate without consultation with or approval of the RTO. For candidates currently employed by SPP, Inc. the RE may cooperate with the RTO on the timing of the employee's transition to minimize disruption to RTO operations; and
6. Review the RE engineering resource requirements and consider hiring additional engineering staff to perform the delegated functions of the RE.

RTO Employees had Inappropriate Influence over Compliance Monitoring and Enforcement Policies

RTO managers were involved with matters relating to NERC and the RE's compliance monitoring and enforcement policies.

Pertinent Guidance

In *Order No. 672*, the Commission stated that an RTO acting as an RE may have an inherent conflict of interest because the same institution would operate the bulk-power system and be responsible for overseeing its own compliance with reliability standards:

A system operator/Regional Entity in a single corporation – absent a very strong separation between the oversight and operations functions – should not oversee its own compliance with Reliability Standards.^[36]

In the *April 19, 2007 Order* approving SPP's delegation agreement and its compliance monitoring and enforcement plan, the Commission stated that it was relying on SPP's assertion that:

the ultimate authority to approve and enforce proposed reliability standards will reside with the SPP Regional Entity trustees, who will operate with a sufficient degree of independence from the SPP RTO. Specifically, SPP asserts that the SPP Regional Entity trustees will be the final arbiter regarding each of the reliability functions and duties delegated to SPP.^[37]

³⁶ *Order No. 672* at P 698.

³⁷ *April 19, 2007 Order* at P 397.

Background

In interviews with audit staff and correspondence with NERC, SPP has represented that Mr. Desselle had no involvement in RE compliance matters.³⁸ However, audit staff found evidence that Messrs. Desselle and Yeung had the opportunity to influence generally applicable NERC compliance monitoring and enforcement policies. Below are examples from emails obtained by audit staff:

- **July 16, 2007:** As a member of NERC's "Regional Manager Plus" listserv, Mr. Desselle was asked by NERC to opine on whether and under what circumstances entities should be subject to fines after self-reports. This initiated a series of emails on the subject among Messrs. Desselle, Yeung and Ciesiel regarding this generally applicable policy.
- **August 23, 2007:** Mr. Desselle told Messrs. Ciesiel and Yeung he was in Chicago taking part in the development of NERC's Compliance Monitoring and Enforcement Plan for general applicability.
- **September 13, 2007:** Mr. Desselle convened a conference call with the RE trustees to discuss the hiring of outside consultants to work with NERC on the compliance audit of the SPP's Reliability Coordinator function. Mr. Desselle informed Mr. Ciesiel of the results of the meeting afterward. Mr. Desselle told audit staff he intervened to mediate a dispute between Mr. Ciesiel and the staff of David Hilt, NERC's vice president and director of compliance, regarding the handling of the audit. Mr. Desselle said Mr. Ciesiel wanted another RE to lead the audit but Mr. Desselle recommended NERC be the lead. Mr. Ciesiel told audit staff it was Mr. Desselle's decision that he not attend the conference call. The RE trustees accepted Mr. Desselle's recommendation.³⁹

³⁸ On November 15, 2007, Mr. Desselle informed NERC that neither he nor Mr. Yeung would take part in the NERC Board of Trustees Compliance Committee's conference call the following day "in keeping with the SPP RE functional separation from the SPP RTO." Instead, Mr. Desselle said Mr. Ciesiel would take part.

³⁹ Mr. Ciesiel continues to resist NERC's oversight of audits of the SPP RTO. In an email dated April 4, 2008, Mr. Ciesiel informed Mr. Desselle and others that NERC will have to negotiate with the SPP RE staff regarding the scope of NERC's 2008 Compliance Audit of the RTO. "The SPP RE does not have the same conflicts of interest issues as FRCC and WECC," Mr. Ciesiel said.

- **April 1, 2008:** Mr. Yeung emailed Mr. Ciesiel with his opinion regarding NERC's generally applicable Guidance on Compliance Violation Investigations (CVIs). Mr. Yeung copied Mr. Desselle on the message (see Appendix, Figure 11).
- **April 3, 2008:** Mr. Desselle forwarded to Mr. Ciesiel ReliabilityFirst's comments regarding NERC's generally applicable guidance on registration of small generators, suggesting SPP RE support ReliabilityFirst's comments. Mr. Yeung was copied on the message.

In addition, SPP withheld a number of emails between Mr. Desselle and Mr. Ciesiel on the ground of attorney-client privilege.⁴⁰ Based on the privilege log provided by SPP, audit staff identified more than 40 emails concerning the following topics: CMEP and delegation agreements; regional entity hearing procedures or settlement guidelines; the definition of the bulk electric system; penalty provisions or the NERC penalty tool; self-certifications and mitigation plans; investigation guidelines, and the audit of SPP's Reliability Coordinator function. SPP also withheld 15 emails related to compliance matters from a one-week sample of Mr. Yeung's emails in June 2007. As discussed below, a number of these withheld emails were forwarded to SPP, Inc.'s President, Chief Financial Officer, Chief Operating Officer and Vice President of Regulatory Policy. All of these subjects of these emails relate to NERC's deliberative process and how it and the REs will enforce compliance, issues in which SPP, Inc. should not be involved.

Audit staff also notes that SPP had only employees shared by the RTO and RE representing it on NERC's Reliability Assessment Subcommittee, unlike the practice of most other Regional Entities, which include RE employees among their representatives.

Recommendations

We recommend the RE:

7. Ensure that RTO managers have no involvement in matters relating to NERC and SPP RE's compliance monitoring and enforcement

⁴⁰ Among those also copied on these emails were SPP General Counsel Stacy Duckett, RE Counsel Alison Hayes and SPP, Inc. external counsel Amanda Riggs Conner of Wright & Talisman, P.C.

policies unless involvement relates to public matters pertaining to RE and NERC processes available to interested parties including RTOs

8. Appoint an RE staff member to represent SPP on NERC's Reliability Assessment Subcommittee and any other committee or subcommittee whose authority includes RE statutory functions.

The RTO has the Ability to Influence the RE's Budget and Expenditures

RTO managers have the ability to influence the RE's budget and spending. Specifically:

- Neither the RE trustees nor RE staff exercised any oversight over the costs allocated by the RTO to the RE.
- RTO managers or the SPP, Inc. Board of Directors must approve unbudgeted RE expenditures in excess of \$10,000.
- RTO staff controls withdrawals from the RE bank account.

Pertinent Guidance

In its *April 19, 2007 Order*, the Commission expressed concern that section 8.3 of the SPP bylaws gives the SPP, Inc. board the authority to "define" the costs associated with the SPP RE. NERC and SPP reassured the Commission that the RE trustees have authority over the contents of the RE budget. NERC and SPP said "define" only meant that SPP will clearly set out, or separately delineate, in its annual budget those costs associated with its Regional Entity responsibilities. To clarify this point, SPP changed the word "define" to "set out" in section 8.3 of the SPP bylaws.⁴¹

In its *March 21, 2008 Order* the Commission found SPP's proposal to ensure that its non-statutory activities are funded separately from its Regional Entity activities "insufficient." The Commission directed NERC and SPP to either revise their Delegation Agreement "to include a list of SPP's specific procedures for ensuring that non-statutory funding will be kept separate from funding for statutory activities, or to provide further explanation demonstrating that SPP's current proposal will accomplish what is required. For example, SPP should

⁴¹ *March 21, 2008 Order* at P 204.

address how its bank accounts and receivable/payable procedures are set up for both the statutory and non-statutory functions.”⁴²

Background

Despite the Commission’s directive that SPP segregate the RE’s funds from the RTO’s funds,⁴³ SPP paid RE expenses out of SPP, Inc.’s operating account. Until April 2008, the RE funds received from NERC were kept in the SPP, Inc. bank account. The RTO staff opened a separate account for the RE in April 2008. SPP noted that the bank account still names SPP, Inc. as the account holder, as SPP RE is not a legal entity. In addition, the individuals authorized to make withdrawals from the account are RTO employees: the Chief Financial Officer, Controller, and Accounting Manager. No approval by the RE trustees is required. In addition, SPP continued to pay RE expenses from the SPP, Inc. operating bank account. The RE bank account is essentially a holding account, from which SPP transfers funds on a quarterly basis to reimburse SPP, Inc. for the expenses it paid during the quarter. For instance, the RE employees’ 2007 bonuses, paid in February, 2008 (before the Commission’s March 21, 2008 order), were paid out of the SPP, Inc. operating bank account. SPP’s payroll for the entire company, including all divisions, is paid from a single account; hence, the RE payroll is paid from the same account as the RTO payroll.

Audit staff has several concerns about SPP’s segregation of funds. First, paying RE costs out of the RTO operating account requires an after-the-fact cost allocation. For instance, due to an accounting oversight, all of the RE trustees’ 2007 travel expenses were paid by SPP, Inc., without reimbursement from the RE. Audit staff believes this oversight would have been less likely had the RE paid its expenses directly out of its own bank account. Second, using the RE account as a holding account limits the RE’s ability to control its own funds. The RE trustees or an independent RE Manager should have authority to authorize withdrawals from the RE bank account. Finally, this arrangement complicates the true-up from budgeted to actual expenditures.

Audit staff believes that the RE’s reliance on SPP, Inc.’s corporate expenditure policies provide SPP, Inc. officials the opportunity to exercise ultimate authority to approve – and potentially overrule – RE expenditures. No formal written policies addressing approval of expenditures exist within the RE. The level of authorization needed for budgeted and unbudgeted expenses is

⁴² *March 21, 2008 Order* at P 214-16.

⁴³ *March 21, 2008 Order* at P 214-16.

dependent on the amount of the expenditure. When expenditures exceed the limit of a manager or director's approval authority, the approval process then relies on the signatures of SPP, Inc.'s Chief Financial Officer, Chief Operating Officer, Vice Presidents, President and the Board of Directors.

For example, in October 2007, the RE incurred an unbudgeted expense when it paid for an upgrade to its Compliance Data Management System (CDMS). The amount for the upgrade was \$18,698, which exceeded Mr. Ciesiel's approval authority for unbudgeted expenses (\$10,000) under SPP policies. Mr. Desselle, who has authority to approve larger unbudgeted expenses as an officer of SPP, approved the purchase.

The RE's process for unbudgeted/unusual expenditures is as follows:

- RE staff requests the RE trustees approve the unbudgeted expense;
- RE trustees asks SPP senior staff whether there are funds in the SPP RE budget to cover such expenses and to confirm that the unusual expenditure is not contrary to an overall corporate goal; and
- RE trustees act upon the RE staff recommendation.

If approved by the RE trustees, RE staff follow the SPP Signature/Purchasing Authorization Policy for unbudgeted expenditures. That policy limits directors such as Mr. Ciesiel to expenditures of \$10,000. Vice presidents, such as Mr. Desselle, are limited to \$100,000. The president may approve amounts up to \$250,000, and – with the concurrence of the CFO – up to \$1 million. The Board of Directors must approve amounts above \$1 million.

Audit staff is also concerned that neither the RE trustees nor any RE employee has oversight over the allocation of costs to the RE for shared employees. In 2007, employees tracked time spent on RE delegated functions in a shared Excel spreadsheet on SPP's network. SPP's Accounting Manager collected the data monthly and computed the direct (the employee's hourly salary) and indirect costs (\$110/hour for overhead and benefits) to be charged to the RE. Beginning in January 2008, a new tool, JournyX, replaced the spreadsheet for tracking employee hours.

A review of employee time sheets used to track hours allocated to RE delegated activities found that the approval authority for charges associated with shared employees resides completely within SPP, Inc. Mr. Yeung, as Regional Entity Manager, reviewed the costs allocated from shared employees, though his focus appears to be on tracking actual versus budgeted RE's costs. There was no independent review by an RE employee of the time charged by SPP, Inc.

employees to the RE. The RE trustees received only a quarterly budget update from Mr. Yeung during the RE trustee meetings. This is a summary report showing the budget variance for the quarter. The RE trustees did not review or approve the expenses charged to the RE.

RTO managers directly affected RE spending when they persuaded the RE trustees to change the ratings used to compute the 2007 performance bonuses for RE employees, as detailed in section A above. In addition, once the RE trustees revised their ratings, it was the RTO managers who controlled the formulas used to compute the bonuses.

Audit staff believes that it is important that the trustees and RE manager have full control over budget formulation and execution. In addition, the trustees and RE manager must have full authority over its spending decisions, including oversight responsibilities for allocated to the RE for shared services. Moreover, the involvement of RTO management in RE budgeting and spending decisions undermines the independence of the RE and its ability to fulfill its functions as envisioned in the Delegation Agreement.

Recommendation

We recommend the RE trustees and RE Manager:

9. Implement processes and procedures to ensure the RE has full authority over its budgeted spending, including RE employees' salaries and bonuses;
10. Implement a process to allow the RE Manager and RE trustees to approve unbudgeted expenses at the same levels that an RTO officer may approve such expense. If the RE seeks to make an unbudgeted expense that exceeds these corporate limits, the RE shall seek Commission approval for a change in its budget;
11. Provide that the RE manager may authorize withdrawals from the RE bank account consistent with the RE budget and eliminate SPP, Inc. management's authority to review or authorize withdrawals from the RE bank account;
12. Have the ability to determine the amount of funds available to the RE at anytime upon request and develop a process for addressing

discrepancies resulting from an audit, bank account reconciliation, or internal reviews of the RE segregated funds;

13. Develop procedures to ensure that the independent RE Manager approves shared employees' allocation of costs to the RE; and
14. Ensure that the RE reimburse the RTO for the RE trustees' 2007 travel expenses.

The RE Trustees' Oversight could be Improved to Prevent Conflicts of Interest and Ensure the RE's Independence

The RE trustees' oversight of the RE operations could be improved to ensure that the RE is operating independently from RTO operations. The trustees played a limited role in hiring the Executive Director of Compliance and have little contact with the RE staff aside from their quarterly meetings. The trustees also were unaware of several important issues. The hiring of a Regional Manager who regularly communicates and consults with the trustees could substantially address audit staff's concerns.

Pertinent Guidance

In the *April 19, 2007 Order* approving SPP's delegation agreement and its compliance monitoring and enforcement plan, the Commission stated that it was relying on SPP's assertion that

the ultimate authority to approve and enforce proposed reliability standards will reside with the SPP Regional Entity trustees, who will operate with a sufficient degree of independence from the SPP RTO. Specifically, SPP asserts that the SPP Regional Entity trustees will be the final arbiter regarding each of the reliability functions and duties delegated to SPP.^[44]

⁴⁴ *April 19, 2007 Order* at P 397.

Background

The RE trustees, John Meyer (retired Vice President of Regional Transmission Organization Activities for Reliant Resources), David Christiano (retired from City Utilities of Springfield, Missouri and a former member of the NERC Engineering and Operating committees), and Gerry Burrows (retired Manager of Transmission Services for Kansas City Power and Light and a former member of the NERC Operation Committee and Standards Drafting Team) were elected by the SPP membership on June 22, 2007. The SPP membership accepted the Corporate Governance Committee's trustee recommendations for Mr. Meyer and Mr. Christiano. The SPP members elected Mr. Burrows on a motion from the floor by an executive with Empire District Electric Company of Joplin, Missouri, seconded by an executive with Westar, Kansas' largest integrated electric utility.⁴⁵

On June 28, 2007, Ms. Duckett sent the trustees a memorandum summarizing action items for their initial meeting on July 11, 2007. Under "staffing" Ms. Duckett wrote: "The director of Compliance reports to the RE trustees. The Trustees must act to hire the Director (Ron Ciesiel)."

Chairman Meyer told audit staff that SPP "suggested ... we strongly consider" Mr. Ciesiel. After interviewing Mr. Ciesiel at the July 11 meeting the trustees hired him, without considering any other candidates. Mr. Meyer said the trustees hired Mr. Ciesiel because he was knowledgeable about "the people [and] program structure."

A week later, on July 18, 2007, Mr. Desselle asked Mr. Ciesiel to rewrite a job description Mr. Desselle had composed for Mr. Ciesiel's new role. Mr. Ciesiel provided the revisions later that day.

For their general counsel, the trustees selected Ms. Hayes from three finalists selected by Ms. Duckett and Mr. Desselle, as described above.

The trustees told audit staff they have limited contact with RE staff between their quarterly meetings. The trustees receive an email report from Mr. Ciesiel and Ms. Hayes once or twice monthly but have little day-to-day involvement with

⁴⁵ At their first meeting, July 11, 2007, Mr. Meyer was elected chairman by Messrs. Burrows and Christiano for a three-year term expiring 2010. Messrs. Burrows and Christiano drew for terms to establish the staggered terms required by the SPP RE Bylaws. Mr. Christiano drew a two-year term expiring 2009 and Mr. Burrows drew a one-year term expiring 2008.

the RE staff. The trustees require Mr. Ciesiel to provide them prior review of Notices of Alleged Violation (NAV) and Penalty Letters for cases in which the RE is recommending penalties in excess of \$150,000.⁴⁶

Chairman Meyer said he speaks to Mr. Ciesiel and Ms. Hayes about once a month each. Trustee David Christiano said he speaks to Mr. Ciesiel and Ms. Hayes with similar frequency. Trustee Gerry Burrows said he “very seldom” talks to Mr. Ciesiel or Ms. Hayes outside of meetings. “It’s not a whole lot of work in terms of hours,” Trustee David Christiano said in explaining his role. “We don’t do hands-on supervising. I don’t ever go to Little Rock.”⁴⁷

In contrast, Mr. Ciesiel exchanged more than 350 email messages with Messrs. Desselle and Yeung between mid-May and late November 2007, an average of nearly three messages per workday.

Mr. Desselle, as co-Regional Entity Manager, has attended all of the quarterly RE trustee meetings and continued his involvement even after the appointment of Mr. Ciesiel and Ms. Hayes. Mr. Yeung, as co-Regional Entity Manager, also attends the RE trustee meetings. Despite his extensive involvement in RE activities, however, Mr. Yeung told audit staff he reports to Mr. Desselle only. He said he has no reporting relationship with the RE trustees.

During the interviews with audit staff, the trustees seemed unfamiliar with some issues germane to their responsibilities. Prior to being informed by audit

⁴⁶ If the trustees do not make an objection to Mr. Ciesiel within 72 hours, the notices are sent as submitted. The trustees are advised at the same time as NERC and the registered entity for Notices of Alleged Violations involving recommended penalties below the \$150,000 threshold. RE Trustee Meeting minutes, January 30, 2008.

⁴⁷ The trustees also reported little contact with Messrs. Desselle and Yeung outside of the quarterly trustee meetings. Chairman Meyer said he speaks with Mr. Desselle no more than once every two months and to Mr. Yeung once a quarter. Mr. Christian reported receiving 11 emails from Mr. Yeung and 16 from Mr. Desselle since October 31, 2007. He said he can recall no phone conversations with Mr. Yeung and only one or two with Mr. Desselle. Mr. Burrows said he receives about one email every two months from Mr. Desselle and speaks with him via phone less than once per quarter. Mr. Burrows said his contacts with Mr. Yeung generally are limited to periods when they are developing the RE’s annual budget.

staff, for example, none of the trustees was aware of Mr. Desselle's responsibility for RTO compliance with NERC rules or that he supervised Mr. Hodges. Chairman John Meyer said he saw no conflict in Mr. Desselle's supervision of Mr. Hodges and his work with the RE.

Trustee Christiano told audit staff he could not recall who suggested the current RE staff mix of dedicated and shared employees. He said he was unaware of Mr. Yeung's involvement in the formulation of the 2008 budget.

Audit staff believes that it would be beneficial if the trustees were more actively involved in overseeing the RE operations even though they are directors that devote only a portion of their time to the RE operations. This could be substantially addressed by the hiring of a full-time RE Manager. The RE manager and RE counsel could assist the trustees in improving the oversight of the RE operations by consistently keeping the trustees abreast of Commission decisions and other critical matters relating to the RE operations. For the day to day operations of the RE, it is important that the trustees hire a full-time RE manager that reports directly to them on all matters affecting the RE operations.

Recommendation

15. Provide a detailed written response explaining how the RE manager and RE counsel plan to keep the trustees better informed of important matters affecting the RE operations.

RTO Employees Have Received Confidential Compliance Information

Audit staff has identified several instances in which RTO employees received confidential RE compliance information. This confidential information includes information about NERC's view on compliance policy as well as information about other registered entities' compliance with the reliability standards.

Pertinent Guidance

NERC's Rules of Procedure limit the disclosure of Compliance Information: "NERC and the regional entities are authorized to exchange confidential information related to evaluations, audits, and investigations in furtherance of the compliance and enforcement program, on condition they

continue to maintain the confidentiality of such information.”⁴⁸ The Rules of Procedure further define confidential information as including “investigative files, including any records produced for or created in the course of an investigation.”⁴⁹

Background

Audit staff has identified numerous instances in which Mr. Yeung and Mr. Desselle shared information about NERC’s and the REs’ internal deliberations regarding compliance policy with SPP, Inc. officers with RTO responsibilities. Audit staff has also identified instances when Mr. Yeung and Mr. Desselle, as well as other RTO managers, have received confidential RE information about other registered entities’ compliance with the reliability standards.

Records show that Messrs. Desselle and Yeung have repeatedly taken part in compliance activities. For example, Mr. Yeung was SPP’s representative at closed meetings of the NERC Board of Trustees Compliance Committee (BOTCC) in May, June, July and September 2007, where compliance officers from the regional entities discuss pending violations, violation trends and enforcement strategies.

In addition, between May and November 2007, Mr. Yeung regularly forwarded his notes from the NERC RE Managers meetings to Mr. Desselle and other SPP, Inc. officers, including SPP, Inc. CEO Nick Brown and Chief Operating Officer Carl Monroe. Mr. Monroe oversees RTO operations and thus shares responsibility with Mr. Hodges and Mr. Desselle for the RTO’s compliance with NERC Reliability Standards (Mr. Ciesiel also received copies). Among the subjects covered were interpretation of standards; hearing procedures; settlement principles and procedures; mitigation plans; the Board of Trustees Compliance Committee agenda; and updates on compliance violations.

Mr. Yeung’s notes concerning the September 28, 2007 meeting included a recounting of discussions between NERC and Commission employees regarding mitigation and compliance issues. Notwithstanding Mr. Yeung’s notation that “some information in these notes may be restricted to RE function only,” Mr. Yeung distributed this email to Mr. Brown, Mr. Monroe, Ms. Duckett, the Chief Financial Officer and the Vice President for Regulatory Policy in addition to Mr. Ciesiel (see Appendix, Figure 10).

⁴⁸ NERC Rules of Procedure, Section 1506.2.

⁴⁹ NERC Rules of Procedure, Section 1501.

Audit staff's review of emails identified several disclosures of confidential compliance information to SPP managers including Messrs. Desselle and Yeung, Compliance Manager David Hodges and SPP, Inc.'s CEO. Among the subjects of the disclosures were:

- SPP's compliance activities;
- self-reports and alleged violations by registered entities within the SPP footprint; and
- discussions between REs and FERC employees regarding interpretations of the CMEP.

For example, on September 4, 2007, Mr. Yeung forwarded to Mr. Desselle BOTCC minutes that were attached to an email from NERC marked "CONFIDENTIAL – NON PUBLIC" (see Appendix for Figure 9, highlighting added).

In addition to the minutes, the email attachment included the following reports on compliance activities:

- "FERC Enforceable Violation Status Update," a spreadsheet listing the names of the registered entities accused of violations and a description of the alleged violations;
- summaries of Pre-June 18 "Amnesty violations," and post-June 18 "Enforceable violations;"
- Compliance Monitoring Initial Notification Information Report for 07/19/2007 - 08/17/2007, and
- a "Mitigation Plans Report."

In a separate email, Mr. Yeung gave Mr. Desselle and Mr. Ciesiel a detailed account of the meeting, which included discussions of the pre- and post-June 18 violations.

On September 13, 2007, Mr. Desselle forwarded to SPP, Inc. CEO Nick Brown and SPP Standards Compliance Manager David Hodges four documents from NERC CEO Rick Sergel including one, "Assessment of Risk – Vegetation Related Outages," that was marked "Confidential – Not for Public Distribution."

The RE took some steps in November 2007 to reduce the flow of confidential compliance information to SPP, Inc. officers and to separate Messrs. Desselle and Yeung from compliance responsibilities. However, Messrs. Desselle

and Yeung have continued to receive sensitive compliance information from NERC.

The distribution of confidential compliance information to RTO managers appears to have continued until at least November 9, 2007, when Ms. Hayes complained to Mr. Desselle that she felt that sharing notes from meetings that discussed compliance “crosses the line of separation.” Ms. Hayes said she is unaware of any improper disclosures to the SPP, Inc. officers after she raised her objection.

On November 15, 2007, Mr. Desselle informed NERC that neither he nor Mr. Yeung would take part in the BOTCC’s conference call the following day “in keeping with the SPP RE functional separation from the SPP RTO.” Instead, Mr. Desselle said Mr. Ciesiel would take part.

Mr. Desselle’s notification to NERC reiterated a decision he announced to Messrs. Yeung and Ciesiel on October 7, 2007 via email in which he said that the RE trustees could represent SPP if Ciesiel were unable to attend. “However, because of the incremental cost associated with sending a Trustee to the BOTCC meetings such occasions should only be utilized as a last resort,” Mr. Desselle said.

In addition, Messrs. Desselle and Yeung continued after November to receive from NERC sensitive information concerning compliance policies. Among the subjects of the disclosures were:

- handling of mitigation plans;
- addressing late self-certifications;
- prioritizing violations;
- NERC’s settlement template;
- NERC draft documents regarding mitigation plans, self-certifications priorities and guidance on penalties; and
- a draft of NERC’s 2007 CMEP Annual Report.

Audit staff is also concerned about physical access to the RE’s work space. The RE staff is housed in offices on the 10th floor of the building where SPP’s headquarters is located separate from the RTO. Its offices are secured by card key access. During audit staff’s site visit, Mr. Desselle used his card key to enter the RE offices unannounced. In response to audit staff’s concerns, the card key access was subsequently reprogrammed to deny access to most RTO employees. However, numerous shared RTO employees, including Messrs. Desselle and

Yeung, continue to have card key access to the RE offices. Mr. Ciesiel said only RE employees have keys to the RE's file room and file cabinets.

Recommendation

16. Develop procedures to ensure that RTO managers and employees are prevented from receiving confidential compliance information and that RTO employees are permitted access to RE offices only when necessary to perform shared RE functions and when accompanied by RE staff. These procedures should include a non-disclosure agreement that shared staff must sign pledging not to reveal confidential RE information.

B. Implementation of the Compliance Monitoring and Enforcement Plan

Audit staff found that the RE did not follow procedures in handling the self-report and mitigation plans for one registered entity (audit staff found no problems in the four other self-reports and mitigation plans we reviewed). Audit staff has several additional concerns and observations concerning the RE's implementation of the CMEP, including:

- late filing of self-certifications;
- vegetation-related outage mitigation plan not completely followed;
- lack of transparency in compliance audit reports; and
- RE employed auditors who audited SPP reliability coordinator.

Pertinent Guidance

In its June 17, 2007 order clarifying NERC procedures on mitigation plans, the Commission noted that “where a user, owner or operator of the Bulk-Power System is found by NERC to be in noncompliance with a Reliability Standard, NERC’s Rules of Procedure require that entity to submit to NERC for approval a mitigation plan with a timeline addressing how the noncompliance will be corrected.”⁵⁰

In its July 3, 2008 Guidance Order on Reliability Notices of Penalty, the Commission stated that the REs and NERC have responsibility for reviewing proposed mitigation plans to ensure that they will bring a registered entity back into compliance within a reasonable time. “The Commission believes that it is important for Regional Entities to document how they verify a registered entity’s certification that it has timely completed a mitigation plan and thereby attained compliance with the applicable Reliability Standard requirements. In future filings, we expect Regional Entities to provide specific information on how they verified that registered entities completed on time mitigation plans to bring themselves into compliance.”⁵¹

⁵⁰ *North American Electric Reliability Corp.*, 119 FERC ¶ 61,274 at P 5 (2007).

⁵¹ *Guidance on Filing Reliability Notices of Penalty*, 124 FERC ¶ 61,015 at P 37 (2008).

Background

*Review of Mitigation Plans*⁵²

A registered entity filed a compliance violation self-reporting form stating that it had not sufficient time to satisfy the documentation requirements of a number of NERC standards applicable to it. The entity also reported that it performed GOP functions at certain plants.

The entity submitted a mitigation plan that predicted completion of its mitigation, but did not include milestones, as required by the CMEP. The RE should have rejected this mitigation plan and required the entity to submit a detailed schedule.

The entity submitted a revised mitigation plan seeking to extend its compliance deadline. The mitigation plan listed 18 standards, including four additional standards not included in the original self-report, and a promise that the entity would register as a GOP. As with the initial mitigation plan, it did not include milestones. Nevertheless, the RE approved the mitigation plan.

The RE should have rejected this update and required the entity to file separate mitigation plans for the additional findings along with a detailed schedule and timeline. The RE also should have required the entity to register as a GOP upon its original mitigation plan submittal. These new mitigation plans would have been applied to the now mandatory and enforceable reliability standards and subject to sanctions and penalties under Docket No. RM06-16.⁵³

Late Filing of Self-Certifications

The RE extended the deadline for self-certification by its registered entities three times in late 2007 and early 2008. Despite the repeated extensions, the

⁵² Details related to the specific mitigation plan at issue in this finding have been redacted in order to avoid releasing non-public information and due to concerns that RTO management involved in the oversight of the RE will review this draft audit report.

⁵³ *Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693, FERC Stats. & Regs. ¶ 31,242, *order on reh'g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

RTO's compliance manager indicated he was not aware of the self-certification deadline until after he was questioned by audit staff during a site visit.

In letters sent to its registered entities on November 27, 2007, the RE initially announced a deadline of January 18, 2008 for completing the self-certification through the RE's Compliance Data Management System (CDMS). On January 18, 2008, the RE extended the deadline to January 25, 2008, due to problems the registered entities had experienced with the CDMS. The RTO's compliance manager received the November 27 and January 18 notices on behalf of the RTO.

On January 29, 2008, the RE extended the deadline a second time, to January 31, 2008. Unlike the previous notices, this notice was sent only to Registered Entities that had not already complied or responded to the previous notices. Although the RTO was among those that had failed to self-certify on time, the RTO did not receive this notice because the CDMS database erroneously listed SPP as an "Administrator Account" rather than an "active" account used for registered entities. This was an oversight by the RE staff when the duties of the pre-RE period were split between the RE staff and the RTO compliance staff.

On February 1, 2008, the RE extended the deadline a third time to February 15, 2008. This notice was sent to seven registered entities that were not in compliance, but again not to the RTO.

As a result of audit staff's questions during its site visit the week of February 4, 2008, SPP officials realized that the RTO had failed to file its self-certification. The RTO completed its self-certification on February 9, 2008. All of the entities, excluding three projects operated by a single registered entity, complied by the February 15 deadline.

Audit staff is concerned that registered entities – including the SPP RTO -- faced no consequences for failing to meet the initial self-certification deadline. Audit staff also notes that the second and third extensions were granted after the previous deadlines had passed. Failure to enforce self-certification deadlines leaves open the possibility that registered entities will be in ongoing and prolonged non-compliance with the reliability standards.

*Vegetation-Related Outage Mitigation Plan*⁵⁴

Audit staff also has concerns about the RE's conclusion regarding a vegetation-related outage. The outage was reported through the normal quarterly reporting procedures to the RE and then on to NERC. The self-report showed that the type of vegetation involved in the incident was a willow tree, a fast-growing tree that the RE said can grow in excess of eight feet in a growing season. This type of tree thrives in full sun and requires a lot of water, conditions present in the area in question during 2007. The entity identified the offending tree through a helicopter patrol after the outage; no other problems were identified on the line.

The RE verified that the entity was in compliance with its vegetation management program, which included a ground survey of the line, and a survey by fixed-wing aircraft on 12 days before the outage. Neither inspection noted the offending vegetation as a danger to the transmission line (the air inspection was performed by a pilot who had purchased the business several months earlier from the entity's long-time contractor).

The entity's mitigation plan added a yearly helicopter survey (in addition to four fixed-wing surveys annually) for "critical"⁵⁵ transmission lines, including the line in question. In addition, the line was added to those patrolled by foot once a year. The entity also agreed to provide more training for the contractor that performs the aerial surveys.

The RE concluded the outage was an "isolated incident and not a systemic or program problem of the Vegetation Management Program," noting that the entity had no other reported vegetation outages.

Asked by audit staff how he knew there were not other untrimmed trees in the entity's right of way, Mr. Ciesiel acknowledged that RE did not know. He indicated that RE staff did not physically inspect the system. Because there were no repeat incidents between the initial outage and the time the RE wrote its report, Mr. Ciesiel said the RE concluded that there must not be any additional untrimmed trees.

⁵⁴ Details related to the specific vegetation-management related mitigation plan at issue in this finding have been redacted in order to avoid releasing non-public information and due to concerns that RTO management involved in the oversight of the RE will review this draft audit report.

⁵⁵ The mitigation plan did not define "critical."

Audit staff is concerned that the RE did not require any additional corroborating evidence from the registered entity. RE staff should have required the entity to provide verifiable evidence that there were no other potential grow-ins related to facilities covered by the vegetation management standard.

SPP RE Employed Auditors who Audited SPP Reliability Coordinator

Three consultants from Power Decisions Consulting (PDC) in Ontario, who assisted the SPP RE on its compliance audits of SPS and Westar, also took part in the NERC audit of the SPP Reliability Coordinator in October 2007. The NERC observer on the SPS and Westar audits also took part in the NERC audit of SPP.

Mr. Ciesiel told audit staff that PDC has stopped performing compliance audits for REs and thus is no longer working for the SPP RE.

Audit staff is concerned that consultants employed by the RE may have a conflict of interest in auditing the SPP Reliability Coordinator. For example, the consultants might fear that issuing a negative report on the Reliability Coordinator could hurt their chances of winning future engagements from the RE.

Recommendations

We recommend the RE:

17. Require detailed completion schedules for all mitigation plans;
18. Work with NERC and the other REs to develop a written policy on extending self-certification deadlines;
19. Develop procedures to ensure the RE staff obtain corroborating evidence to verify a registered entity's compliance following a self-report;
20. Ensure that NERC performs all audits of SPP, Inc.'s registered entity functions (Reliability Coordinator, Transmission Service Provider, Transmission Planner, Reserve Sharing Group and Planning Authority), including all facets of these audits, from audit commencement and pre-audit survey to final audit report.

Appendix

Organizational Charts Illustrating Michael Desselle’s Dual Roles

In addition to his duties on behalf of the RE, Michael Desselle also directly supervises the RTO’s Standards Compliance Manager, David Hodges (see Figure 4).

Figure 4

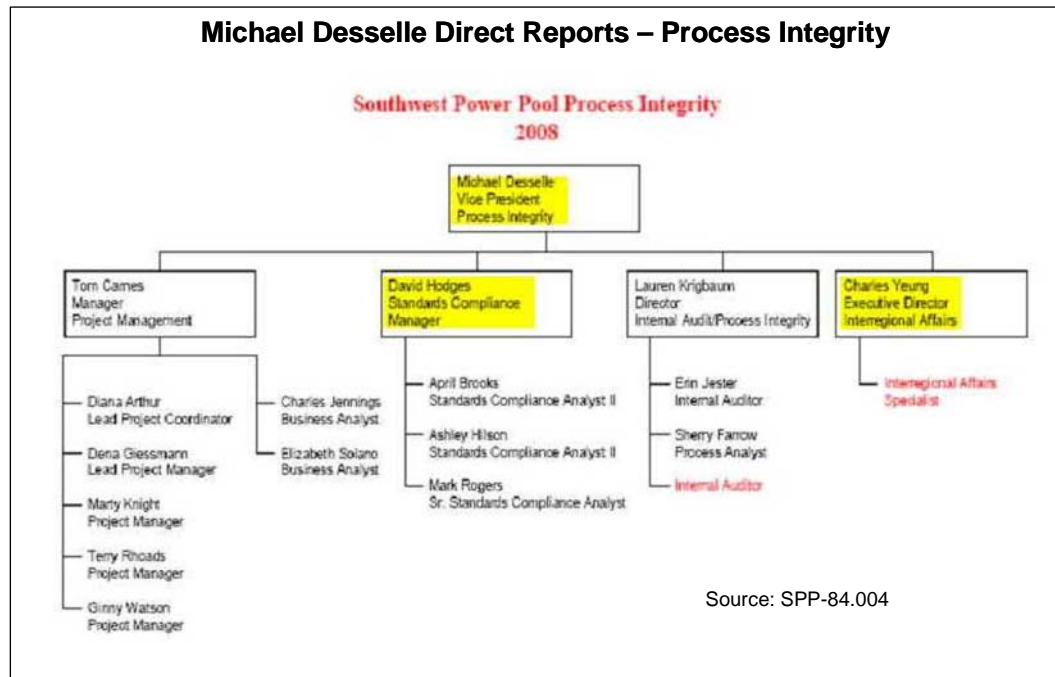


Figure 5

Prior to SPP’s designation as an RE in April 2007, the RTO’s reliability compliance function, then headed by Ron Ciesiel, reported to the board’s Compliance Committee with a “dotted line” to Mr. Desselle. See Figure 5, from a presentation to the SPP, Inc. Board of Directors in July 2007 (names have been added in parentheses).

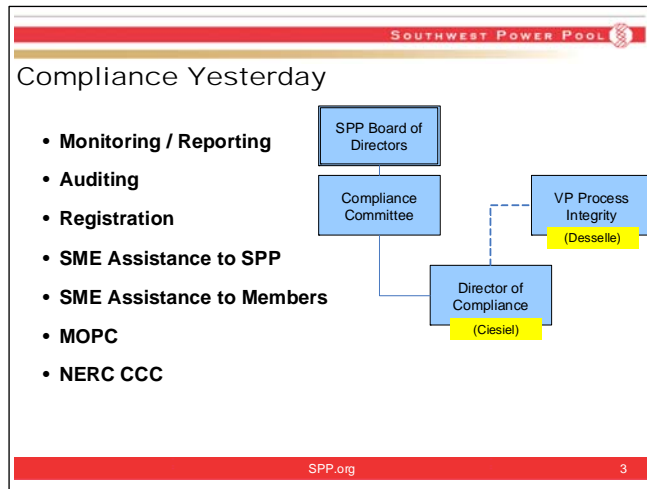


Figure 6

When the RE was established, Mr. Ciesiel was appointed the RE’s executive director of compliance and David Hodges took Mr. Ciesiel’s responsibility for ensuring the RTO’s compliance with NERC reliability standards. In that role, Mr. Hodges reports directly to Mr. Desselle (see Figures 6 and 7, also from the Board of Directors presentation).

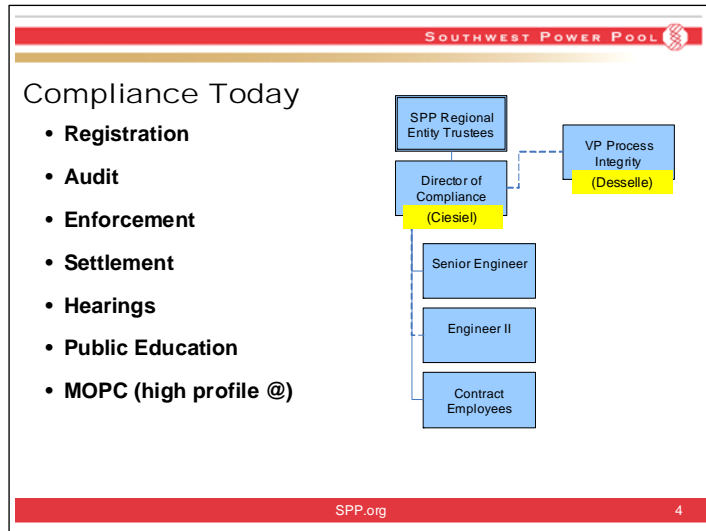
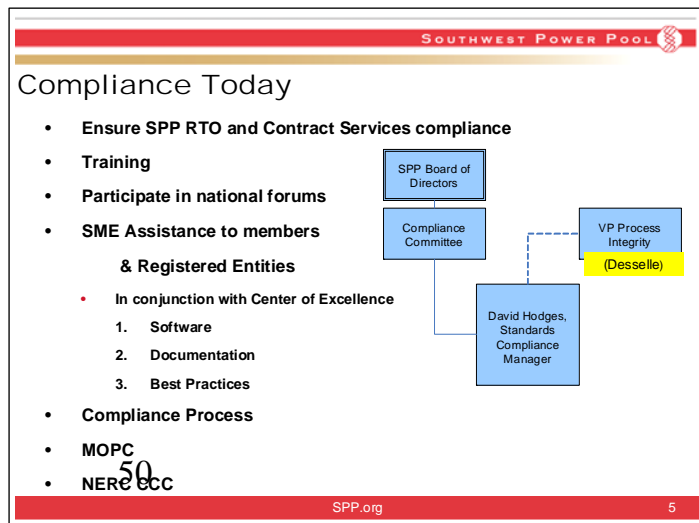


Figure 7



In an email discussing budget submissions in July 2007, Desselle identified Messrs. Yeung, Ciesiel and David Hodges, the RTO's manager of compliance, among his "direct reports."

-----Original Message-----
From: Michael Desselle
Sent: Wednesday, July 11, 2007 11:08 AM
To: Scott Smith
Cc: 'billwylie@cox.net'; Ron Ciesiel; Charles Yeung; Tom Carnes;
David Hodges; Bruce Rew; Dianne Branch
Subject: Fw: Outside services

Fyi. I am forwarding my note to Barbara, letting you know that I have not added any outside services \$s for Process Integrity.

I am also copying my direct reports for their info.

One particular note: the RE budget does include consulting dollars.
Sent from wireless device

Michael Desselle
mdesselle@spp.org

Figure 8

Examples of Improper Disclosures of Confidential Compliance Information

Audit staff's review of emails revealed the following improper disclosures of confidential compliance information to Mr. Desselle and/or Mr. Yeung:

- **July 10, 2007:** Jay Caspary, SPP's Director of Engineering, collaborated with Mr. Yeung in preparing a presentation that included statistics on mitigation plans that Mr. Yeung said had to be removed "due to NERC confidentiality concerns." The presentation was for SPP's Market Operations and Policy Committee (see email July 9, Re: MOPC presentation; July 10, 2007 cc'd to Ron Ciesiel, "Revised NERC Report for MOPC").
- **July 25, 2007:** Minutes indicate Messrs. Desselle and Yeung attended a meeting of the RE trustees in which Mr. Ciesiel briefed the trustees on 160 pre-June 18 violations "in detail." Mr. Desselle confirmed to audit staff that he was present for this discussion.
- **July 31, 2007:** Minutes indicate Mr. Yeung reported to NERC's BOTCC on SPP's compliance activities:

Charles Yeung [reported] SPP had 165 violations remaining open including 5 leftover from previous years. Most of the violations are in the area of documentation and SPP considers them as low risk. Many of the violations come from newly registered entities and no violations have mitigation dates that extend beyond the end of the year. SPP did not have any violations reported post-June 18. Highest risk violations are in the PRC standards and SPP reported one 2006 violation that is still outstanding that remained a concern and SPP was closely monitoring its progress.

After the meeting, Mr. Yeung wrote Mr. Ciesiel an email, saying the "2 pager that you provided at the RET (RE Trustees) meeting last week was a life saver at the BOTCC."

He continued:

Apprently [sic] most of the Res submitted summary reports of their compliance status.

Can you send me a copy of that high level report – Stamped “Confidential for BOTCC”? I need to forward NERC a copy.

We can talk about how to put together a BOTCC-SPP summary for future meetings so you don’t have to be there in person.

- **Aug. 13, 2007:** Mr. Desselle received confidential compliance information as part of the agenda and background material for the Aug. 20, 2007 meeting of the SPP RE trustees (email from Cheryl Robertson, SPP, Aug. 13, 2007). Among the attachments was “2007 NERC Linear Performance Reporting Summary - 2007 Reliability Standards,” a spreadsheet detailing self-reports and other alleged violations by SPP registered entities.
- **Aug. 17, 2007:** In an email to Mr. Ciesiel, SPP CEO Nick Brown, Mr. Desselle and the other SPP officers, Mr. Yeung gave a detailed report of the NERC RE conference call. Among the items discussed were meetings between WECC and FERC staff and MRO and FERC staff regarding interpretation of the CMEP.
- **Sept. 4, 2007:** Mr. Yeung forwarded to Mr. Desselle BOTCC minutes that were attached to an email from NERC marked “CONFIDENTIAL – NON PUBLIC” (figure 9, highlighting added). In addition to the minutes, the email attachment included the following reports on compliance activities:
 - “FERC Enforceable Violation Status Update,” a spreadsheet listing the names of the registered entities accused of the violation and a description of the alleged violation;
 - “Vegetation-Related Transmission Outages” for the second quarter of 2007;
 - Summaries of Pre-June 18 “Amnesty Violations,” and post-June 18 “Enforceable violations;”
 - Compliance Monitoring Initial Notification Information Report for 07/19/2007 - 08/17/2007;
 - A “Mitigation Plans Report,” and
 - Charts on violations by region; the standards with the most reported violations and the registered entities with the most violations.

Figure 9

From: Charles Yeung
 Sent: Tuesday, September 04, 2007 8:03 AM
 To: Ron Ciesiel; Michael Desselle
 Subject: FW: CONFIDENTIAL-NON PUBLIC: BOTCC Meeting Agenda - September 4
 Sensitivity: Confidential
 Attachments: BOTCC090407a_Package_RECM.pdf

Ron, looks like per the FERC Staff visit, SPP and FRCC are getting "special" emails for this.

I just received notice of this Friday afternoon, please call me or send me a note if there is anything I need to report for SPP.

Charles Yeung
 Executive Director Interregional Affairs
 Southwest Power Pool
 832-724-6142

From: Katharine Calla [mailto:Katharine.Calla@nerc.net]
 Sent: Friday, August 31, 2007 3:15 PM
 To: srogers@frcc.com; Charles Yeung
 Cc: David Hilt; Mike DeLaura; Cook, David
 Subject: CONFIDENTIAL-NON PUBLIC: BOTCC Meeting Agenda - September 4
 Sensitivity: Confidential

TO: Sarah Rogers
 Charles Yeung

I have attached the agenda for the Board of Trustees Compliance Committee Meeting on September 4 at 10 a.m. Eastern Time.

This information is considered confidential non-public and for use by the regional entity only. To the extent you work for a registered entity, you are reminded of your obligations of non-disclosure or other inappropriate use of this information within your organization or any other registered entity as required by the NERC Rules of Procedure, the Regional Entity Delegation Agreement, and the regional entity employees' code of conduct responsibilities.

If you have any questions, please contact me.

Katharine Calla
 North American Electric Reliability Corporation
 116-390 Village Blvd.
 Princeton, New Jersey 08540
 609-452-8060
 Fx: 609-452-9550

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In a separate email, Mr. Yeung gave Mr. Desselle and Mr. Ciesiel a detailed account of the meeting, which included discussions of the pre- and post-June 18 violations.

- **Sept. 13, 2007:** Mr. Desselle forwarded to Nick Brown and SPP Standards Compliance Manager David Hodges four documents from NERC CEO Rick Sergel including one, “Assessment of Risk – Vegetation Related Outages,” marked “Confidential – Not for Public Distribution.”
- **October 3, 2007:** Mr. Yeung’s notes concerning the September 28, 2007 RE managers meeting included a recounting of discussions between NERC and the Commission regarding mitigation and compliance issues. Notwithstanding Mr. Yeung’s notation that “some information in these notes may be restricted to RE function only,” Mr. Yeung distributed this email to Mr. Brown, Mr. Monroe, Ms. Duckett, the Chief Financial Officer and the Vice President for Regulatory Policy. See Figure 10 (excerpted).

Figure 10

From: Charles Yeung
Sent: Wednesday, October 03, 2007 5:04 AM
To: Michael Desselle; Stacy Duckett; Tom Dunn; Les Dillahunty; Carl Monroe; Ron Ciesiel
Cc: Nick Brown
Subject: NERC RE Managers Calls Sept 28

Apologies for not getting this out sooner.

(please note that some information disclosed in these notes may be restricted to RE function only)

RE Managers Only Call @ 11 AM

1. SPP, WECC and FRCC will require a third party to lead audits of their region’s RC. NERC staff may not be ready to lead an audit. Some REs proposed their staff to lead for another. SPP’s position is that the Delegation Agreement allows either the RE or NERC to perform audits, not third part REs.

Mr. Desselle continued to have access to sensitive information concerning NERC compliance policies after his November 2007 self-imposed separation from compliance activities:

- **March 5, 2008:** Mr. Yeung forwarded to Messrs. Ciesiel and Desselle a draft letter from NERC's David Nevius on resolving outstanding issues regarding mitigation plans; addressing late self-certifications and prioritizing violations.
- **March 10, 2008:** Mr. Yeung forwarded to Messrs. Desselle and Ciesiel NERC's settlement template.
- **March 14, 2008:** Mr. Desselle received from NERC draft documents regarding mitigation plans; self-certifications; priorities and guidance on penalties.
- **March 18, 2008:** Mr. Yeung forwarded Mr. Desselle NERC's final guidance on mitigation plans.
- **April 22, 2008:** Mr. Yeung forwarded Mr. Desselle a draft of NERC's 2007 CMEP Annual Report.
- **April 26, 2008:** Mr. Yeung sent SPP RTO managers overseeing shared RE employees an email asking them to explain why the RE was under budget. He attached a spreadsheet with worksheets titled "expense download;" "time download;" "summary," and "income statement summary," noting it included "confidential information."

Examples of SPP RTO Managers' Involvement in Compliance Matters

In interviews with audit staff and correspondence with NERC, SPP has represented that Mr. Desselle has no involvement in RE compliance matters. However, audit staff found evidence that Messrs. Desselle and Yeung had the opportunity to influence NERC compliance monitoring and enforcement policies – a direct conflict between their roles with the RTO and RE.

Below are examples from emails obtained by audit staff:

- **July 16, 2007:** As a member of NERC's "Regional Manager Plus" listserv, Mr. Desselle was asked by NERC to opine on whether and under what circumstances entities should be subject to fines after self-reports. Email from Rick Sergel 7-16-08. This initiated a series of emails on the subject among Messrs. Desselle, Yeung and Ciesiel. Email July 18, 2007.
- **August 23, 2007:** Mr. Desselle told Messrs. Ciesiel and Yeung he was in Chicago taking part in the development of NERC's Compliance Monitoring and Enforcement Plan. Emails 8-23-07, 8-29-07.
- **Sept. 13, 2007:** Mr. Desselle convened a conference call with the RE trustees to discuss the hiring of outside consultants to work with NERC on the audit of the SPP's Reliability Coordinator function. Mr. Desselle informed Mr. Ciesiel of the results of the meeting afterward. Email 9-13-07. Mr. Desselle told audit staff he intervened to mediate a dispute between Mr. Ciesiel and the staff of David Hilt, NERC's Vice President and Director of Compliance, regarding the handling of the audit. Mr. Desselle said Mr. Ciesiel wanted another RE to lead the audit but Mr. Desselle recommended NERC be the lead.⁵⁶ Mr. Ciesiel told audit staff it was Mr. Desselle's decision that he not attend the conference call. The RE trustees accepted Mr. Desselle's recommendation.

⁵⁶ Mr. Ciesiel continues to disagree with at NERC's oversight of audits of the SPP RTO. In an email April 4, 2008, Mr. Ciesiel informed Mr. Desselle and others that NERC will have to negotiate with the SPP RE staff regarding the scope of NERC's 2008 Compliance Audit of the RTO. "The SPP RE does not have the same conflicts of interest issues as FRCC and WECC," Mr. Ciesiel said.

- **April 1, 2008:** Mr. Yeung emailed Mr. Ciesiel with his opinion regarding NERC's Guidance on Compliance Violation Investigations (CVIs). Mr. Yeung copied Mr. Desselle on the message (see Figure 11).

Figure 11

From: Charles Yeung
Sent: Tuesday, April 01, 2008 7:04 PM
To: Ron Ciesiel
Cc: Michael Desselle
Subject: FW: Guidance on EAs and CVIs - 032808 (3)

Ron, my thoughts:

If the RE is also a registered entity, the RE should have the option to participate in the CVI or not. Or perhaps participate only as an observer. The document is now written as a must. My concern is forcing the RE into a conflict with itself if it must be on the team. From page 3:

In the case of a multi-region event, NERC will normally initiate and lead the CVI. If the region itself is registered and responsible for one or more reliability functions associated with the event, NERC will initiate the CVI AND the RE compliance staff will participate in the CVI.

As for FRCC's question about what happens if FERC initiates a CVI, my opinion is that first, we will have to abide by any FERC mandates – then if not specified by FERC, the RE should determine on its own to what extent it wishes to be the lead role in the CMEP process so as to avoid any conflict of interest, e.g.- informing registered entities. I am concerned that NERC would want the RE to do more than what the RE may be comfortable with.

Does this statement trouble you as far as what is required in the CMEP? Seems like it provides too much authority to one NERC staff person.

Regional Entities do not have the right to decline to initiate a Compliance Violation Investigation if the NERC Compliance Person calls for an investigation to be initiated.

I also think there should be a reference in this guidance to who issues the Event Analysis Data Request letter to the entities if the RE is a possible entity with a violation. Who would issue it to the RE? Or is that not necessary?

Charles Yeung
Executive Director Interregional Affairs
Southwest Power Pool
832-724-6142

- **April 3, 2008:** Mr. Desselle forwarded to Mr. Ciesiel Reliability First's comments regarding NERC's guidance on registration of small generators, suggesting SPP RE support Reliability First's comments. Mr. Yeung was copied on the message.

ATTACHMENT B

ATTORNEYS AT LAW

WRIGHT & TALISMAN, P.C.

1200 G Street, N.W.
Suite 600
Washington, D.C. 20005-3802
202-393-1200
FAX 202-393-1240
www.wrightlaw.com

December 10, 2008

Via Electronic Mail

Bryan K. Craig
Director, Division of Audits
Office of Enforcement
Federal Energy Regulatory Commission
888 First St. N.E.
Washington, D.C. 20426

Re: Southwest Power Pool, Inc., Docket No. PA08-2-000

Dear Mr. Craig:

Southwest Power Pool, Inc. ("SPP") provides the following response to the November 19, 2008 Revised Draft Audit Report ("Revised Draft Audit Report" or "Report")¹ of the Division of Audits of the Federal Energy Regulatory Commission's ("FERC" or "Commission") Office of Enforcement ("Audit Staff") related to SPP's function as a Regional Entity ("RE").

I. SUMMARY OF SPP'S RESPONSE

SPP has reviewed the Revised Draft Audit Report and has carefully considered its recommendations. SPP believes that the meeting with Audit Staff on October 31, 2008 to discuss the initial draft was very productive, and the Revised Draft Audit Report includes a number of important revisions discussed during that meeting.

While SPP does not agree with all of the individual findings included in the Revised Draft Audit Report, with only one minor exception, there now appears to be general agreement regarding the recommendations in the Revised Draft Audit Report. As SPP has informed Audit Staff, the SPP RE already has decided to hire a full-time Regional Manager. Reporting directly to the RE Trustees, the Regional Manager will provide leadership and vision for the RE, and, most importantly in terms of addressing the concerns of the Revised Draft Audit Report, will oversee the execution of RE strategic direction and independently direct the day-to-day operations of the RE. The Regional Manager will be responsible for the SPP RE's success in promoting a reliable bulk power system within the region and performing the delegated statutory

¹ On December 3, 2008, Audit Staff provided a further revised draft to SPP, although it maintains the draft date of November 19, 2008. This response is directed to this further revised draft provided on December 3.

Mr. Bryan K. Craig
December 10, 2008
Page 2

functions approved by the Commission and embodied in the Delegation Agreement with NERC. As the Revised Draft Audit Report indicates, the hiring of the Regional Manager, along with the other recommendations, will address all of the concerns raised by the Report.

Although there is general agreement on the recommendations and SPP does not contest them (with one exception), SPP continues to disagree with several of the factual findings in the Revised Draft Audit Report, which are discussed in this response. Several findings imply that employees of SPP, Inc. acted in an improper manner during the audit period. SPP disputes any such inferences. The findings do not reflect clearly that Audit Staff's concerns relate primarily to the structure of SPP's separation of RTO and RE functions during the audit period, not actual impermissible conduct by SPP employees. Similarly, SPP disputes the Revised Draft Audit Report's characterizations of the performance of the SPP RE Trustees. As discussed below, the findings regarding the Trustees' performance are both factually incorrect and beyond the authority of the Commission and Audit Staff to address. The Trustees have performed their functions in complete accordance with law and the normal functioning of a corporate board. SPP disputes any findings that imply otherwise.

Nonetheless, as noted, with only one exception, SPP does not contest the recommendations of the Report and agrees to implement them as described below.

II. SPP RESPONSE

As an overall matter, SPP re-emphasizes the purpose of the audit. As indicated in the Audit Commencement Letter, the purpose of the audit is to determine whether SPP was operating in compliance with: (1) the SPP Bylaws, (2) the Delegation Agreement between the North American Electric Reliability Corporation and SPP, Inc. and the conditions included in the *Delegation Order*, (3) the SPP Membership Agreement, (4) the transmission provider obligations described in the SPP Open Access Transmission Tariff and (5) other obligations and responsibilities as approved by the Commission.

Several of the findings in the Revised Draft Audit Report do not appear to measure SPP's compliance with its Bylaws and the Delegation Agreement, as approved by the Commission. Rather, many findings appear to be freestanding determinations as to how Audit Staff believes the SPP RE should be organized and function, without regard to the specifications of the SPP Bylaws and the SPP Delegation Agreement that the Commission approved. SPP maintains that the actions it and its employees took during the audit period violated neither the SPP Bylaws nor the Delegation Agreement.

A. **The Commission Approved the SPP Delegation Agreement and the General Arrangements Under Which the SPP RE is to Operate Within SPP, Inc.**

The Commission specifically addressed the concept of RTOs and REs operating within a single corporation when it issued Order No. 672. The Commission recognized that section 215 of the Federal Power Act did *not* prohibit such an arrangement. The Commission pointed out

that “having a separate RTO/ISO and Regional Entity could lead to duplicative efforts and *higher costs* for consumers.”²

While the Commission did express some concerns about such arrangements, those concerns related *only* to the separation of transmission operations and enforcement/Reliability Standard development. As the Commission stated, “[a] system operator/Regional Entity in a single corporation – absent a very strong separation between the *oversight and operations* functions – should not oversee its own *compliance* with Reliability Standards.”³ Accordingly, the Commission required a combined system operator/regional reliability council seeking RE status to: “demonstrate a strong separation plan with sufficient protections. The separation plan must show full independence between the *enforcement/Reliability Standard development* and the *transmission operations*.”⁴ As discussed below, many of the findings in the Report mistakenly assume there should be complete independence and separation of all RTO and RE functions, rather than separation of the enforcement and operations functions as directed by the Commission. As a result, the Report incorrectly questions many of the shared services that the Commission approved for the SPP RE.

The stakeholders in the SPP region specifically chose the Commission-accepted path of a combined system operator and regional entity within a single corporation, in order to avoid the duplicative efforts and higher costs to consumers that other avenues would have entailed. Maintaining these functions within one company provides more efficient and effective use of resources, as well as facilitating greater participation from all stakeholder groups regardless of size and/or resources.

The Commission accepted the proposed establishment of the SPP RE with this form and structure when it approved the Delegation Agreement between NERC and SPP in April 2007.⁵ The Commission noted, in particular, that the SPP Delegation Agreement “will promote effective and efficient administration of the bulk-power system.”⁶ While the Commission reiterated that an applicant would have the burden of demonstrating a strong separation of operations and oversight functions as between the RTO and the Regional Entity, the Commission acknowledged that SPP met this burden “because the ultimate authority to approve and enforce proposed

² *Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, 2006-2007 FERC Stats. & Regs., Regs. Preambles ¶ 31,204, at P 688, order on reh’g, Order No. 672-A, 2006-2007 FERC Stats. & Regs., Regs. Preambles ¶ 31,212 (2006) (emphasis added).

³ *Id.* at P 698 (emphasis added).

⁴ *Id.* at P 700 (emphasis added).

⁵ *See N. Am. Elec. Reliability Council*, 119 FERC ¶ 61,060 (“April 19 Order”), order on reh’g, 120 FERC ¶ 61,260 (2007).

⁶ April 19 Order at P 231.

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reliability standards will reside with the SPP Regional Entity trustees, who *will operate* with a sufficient degree of independence from the SPP RTO.”⁷ Thus, the Commission found that the general arrangements under which the SPP RTO and the SPP RE would operate within the same corporation satisfied the requirements of Order No. 672 and section 215 of the Federal Power Act. To address its limited remaining concerns with the structure, the Commission required SPP to submit modifications to the arrangements,⁸ which were included in a compliance filing dated October 30, 2007.

The Commission approved SPP’s submitted modifications to its Bylaws and the Delegation Agreement in a March 2008 order.⁹ The Commission accepted the amended and restated SPP Delegation Agreement, effective 15 days later on April 5, 2008. The Commission also directed NERC and SPP to submit a few additional revisions to the SPP Delegation Agreement.¹⁰

While the Commission expressed some concern regarding the adequacy of the separation of functions given SPP’s dual function as an RTO and a Regional Entity, the Commission approved the revised Delegation Agreement. The Commission noted that an audit had been initiated “to further *inquire* into SPP Regional Entity’s organizational structure and practices” and that “[a] final Commission determination regarding the adequacy of the separation of functions between SPP Regional Entity and SPP RTO will remain *pending* the results of the audit.”¹¹ However, the Commission did not condition its approval of the RTO/RE arrangements, and it did not provide that the audit would prescribe new requirements beyond the scope of the approved Delegation Agreement and SPP Bylaws or set new standards against which the separation of functions would be based.

The purpose of the audit, as stated in the Audit Commencement Letter, is to address whether SPP is violating the Bylaws and Delegation Agreement approved by the Commission, or any other requirements that the Commission by order has specifically imposed upon SPP.¹² As discussed below, SPP maintains that there have not been any such violations. While the Commission may take note of the audit in future proceedings regarding the Delegation Agreement, the audit cannot change the Bylaws or Delegation Agreement or what is required by them.

⁷ *Id.* at P 397 (emphasis added).

⁸ *Id.* at P 398.

⁹ *N. Am. Elec. Reliability Council*, 122 FERC ¶ 61,245 (2008) (“March 21 Order”).

¹⁰ *Id.* at P 216. NERC and SPP submitted these revisions in a compliance filing on July 21, 2008.

¹¹ *Id.* at P 212.

¹² *See, e.g.*, “Audit Process Guidance,” available at <http://www.ferc.gov/enforcement/audits/audit-process.pdf>.

B. The Commission Has Recognized That Shared Services Promote Efficiency and Do Not Compromise Independence.

By approving the SPP Delegation Agreement, the Commission also accepted SPP's RE arrangements as meeting the "strong separation" required under Order No. 672. The approved Delegation Agreement and revisions to the SPP Bylaws were clear that the SPP RE would operate within SPP, Inc. and that certain SPP, Inc. services would be shared between SPP's RTO and RE functions. The Commission specifically acknowledged that SPP operating as both an RTO and an RE was not prohibited by section 215 of the Federal Power Act. Thus, the Commission recognized the efficiency of shared services and understood that the presence of shared services does not constitute a failure of strong separation. The Revised Draft Audit Report's conclusions that there has not been strong separation are contrary to the determinations that the Commission has already made.

Strong separation envisions independence where necessary, side-by-side with shared services where efficient. The key to achieving strong separation is to balance efficiency and separation; it is not a matter of prohibiting efficient shared services. The independence requirement in Order No. 672 relates *only* to the separation of enforcement/Reliability Standard development and transmission operations. The independence requirement does not apply to every activity performed by shared staff. If that were the standard, the use of shared staff would be impossible.

Shared corporate services, as approved by the Commission, do not compromise the independence of internal divisions of an organization. For example, the Commission's policy regarding the use of internal market monitors illustrates that "independence" is not threatened by the presence of shared services. The Commission has explicitly permitted the use of internal market monitoring units that use many of the resources of the RTO, such as the services of the human resources department, accounting staff, facilities, and information technology staff.¹³ The Commission has also endorsed the use of shared services in its Standards of Conduct applicable to the relationship between transmission providers and their marketing affiliates and its Affiliate Restrictions applicable to franchised public utilities and their power sales affiliates. The Commission's rules in these areas require "functional" separation (independence) between the respective departments or affiliates of the corporate entity.¹⁴ However, they specifically allow for the sharing of "support employees," which include those in "legal, accounting, human

¹³ Similarly, many corporations, including public utilities regulated by the Commission, have independent audit departments. They use the shared services of the corporation, such as the services of the accounting, human resources, information technology, legal and other departments.

¹⁴ See 18 C.F.R. §§ 35.39(c), 358.4.

resources, travel and information technology.”¹⁵ With respect to both sets of rules, the Commission also explicitly allows the sharing of senior officers and directors without compromising the required functional separation.¹⁶

Moreover, the Commission’s own employees within the Office of Administrative Law Judges and the Office of Enforcement, as well as employees serving as Trial Staff in Commission proceedings, operate independently of the Commission and are subject to strict separation of functions requirements.¹⁷ Yet, all of these employees share the administrative services of the Commission.

Sharing of services between the SPP RTO and the SPP RE similarly does not establish that the SPP RE lacked independence from the SPP RTO function, as the Revised Draft Audit Report repeatedly finds. Shared services are expressly contemplated and authorized by the Commission’s approval of the SPP Delegation Agreement and are common to many other arrangements within a corporation where divisions operate with independence. The RE needs to be independent in the functions where independence is critical (like compliance and enforcement), but it does not need to be independent in other areas where shared services produce specifically contemplated efficiencies and cost savings to consumers. The RE’s reliance on SPP’s general corporate services and engineering expertise does not contravene the principle of strong separation. It promotes efficiency without compromising RE independence.

¹⁵ See *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services By Public Utilities*, Order No. 697, 2006-2007 FERC Stats. & Regs., Regs. Preambles ¶ 31,252, at PP 563-64 (2007), *order on clarification*, Order No. 697-A, III FERC Stats & Regs., Regs. Preambles ¶ 31,268 (2008); *Standards of Conduct for Transmission Providers*, Order No. 2004, 2001-2005 FERC Stats. & Regs., Regs. Preambles P 31,155, at P 96 (2003), *order on reh’g*, Order No. 2004-A, 2001-2005 FERC Stats. & Regs., Regs. Preambles ¶ 31,161 (2004), *order on reh’g*, Order No. 2004-B, 2001-2005 FERC Stats. & Regs., Regs. Preambles ¶ 31,166 (2004), *order on reh’g*, Order No. 2004-C, 109 FERC ¶ 61,325 (2004), *order on reh’g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), *vacated and remanded as it applies to natural gas pipelines*, *Nat’l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006).

¹⁶ Order No. 2004 at P 103. The Commission reiterated, on rehearing, that transmission providers and their marketing affiliates “should be permitted to share employees to conduct corporate governance functions, to take advantage of the efficiencies of corporate integration and to respond to emergency circumstances.” Order No. 2004-A at P 134. See also Order No. 697 at P 562.

¹⁷ See 5 U.S.C. § 554(d) (investigative or prosecuting functions conducted separately from agency decisionmaking); 18 C.F.R. § 385.2202 (same); see also *Ex Parte Contacts and Separation of Functions*, Notice of Proposed Rulemaking, 123 FERC ¶ 61,158 (2008).

C. Shared Services Are Efficient and Constituted a Key Reason Behind the Stakeholders' Support for the SPP RE.

The SPP RE was specifically set up such that it would operate within SPP, Inc., allowing the SPP RE to benefit from the efficiencies of shared services. This arrangement keeps costs down, resulting in just and reasonable rates, one of the primary goals of the Commission.¹⁸ The arrangements were established with the consent and desire of the region's stakeholders, who recognized SPP's efficient administration of both transmission service and enforcement of the region's reliability over the past decade. The arrangements established by the SPP stakeholders lower the cost of providing this element of delivering electricity to consumers, at a time of soaring other costs, such as commodity costs and the costs of building needed infrastructure. Unlike some costs that the Commission recently recognized are not controllable and will, unfortunately, lead to increased costs to consumers (e.g., fuel, iron, steel, and copper wiring),¹⁹ SPP and the Commission can control costs to consumers through the efficiencies of shared services. The Commission recognized this in accepting the SPP Delegation Agreement, explicitly finding that the arrangement would result in efficiencies.²⁰

As none of SPP's actions during the audit period were inconsistent with the SPP Bylaws or the Delegation Agreement, there should be no implication in any findings that there was impermissible "control" or "undue influence" stemming from the permitted use by the RE of shared employees. In SPP's view, the Revised Draft Audit Report should more clearly reflect what SPP understands to be Audit Staff's concern -- that the structure of SPP's shared services may give rise to the "potential" or "opportunity" for control or influence that Audit Staff believes should not exist. The Report should not imply that the proper use of shared services has led to prohibited conduct or violations of the approved arrangements during the audit period.

D. The Revised Draft Audit Report Improperly Addresses the Trustees' Performance.

SPP appreciates that the Revised Draft Audit Report makes some revisions to its findings regarding the RE Trustees and their performance of their corporate duties. However, a number of factually erroneous findings and conclusions remain in the Revised Draft Audit Report. SPP understands from its meetings and discussions with Audit Staff that it is satisfied that the hiring of a Regional Manager, and his and other RE employees' abilities to manage the day-to-day operations of the RE and to keep the RE Trustees informed on important matters, will address Audit Staff's concerns about independent oversight of the SPP RE. Given this, SPP believes that the Revised Draft Audit Report should refrain from factual findings that inappropriately

¹⁸ See, e.g., 16 U.S.C. § 824d.

¹⁹ See FERC News Release, "FERC Examines Causes of, Responses to Rising Electricity Costs," (June 19, 2008). The release is available at: <http://www.ferc.gov/news/news-releases/2008/2008-2/06-19-08-A-3.asp#skipnavsub>.

²⁰ See April 19 Order at P 376.

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characterize the performance of the RE Trustees in a manner that is inconsistent with the duties of a corporate trustee. The findings are incorrect and extend beyond the Commission's authority to regulate corporate governance.

The Commission may not regulate the performance of individual members of the Board of Trustees. The Commission's authority is to regulate the entities over which it has jurisdiction (such as public utilities and REs); it is not to regulate their boards and management.²¹ How Board members or Trustees of entities regulated by the Commission exercise their duty of care, and the extent to which they are or must be involved in the day-to-day affairs of the organization, are matters that are entirely the subject of state corporation law.²²

SPP understands that its acceptance of the Revised Draft Audit Report's recommendation that the RE describe how the RE Manager will keep the Trustees informed satisfies Audit Staff's concerns about RE oversight. Like the duties of any corporate officer, the RE Manager's responsibilities will include this role. However, the Revised Draft Audit Report should not improperly conclude that the RE Trustees' performance during the audit period was inadequate in any respect.

III. SPP'S SPECIFIC RESPONSES TO THE DRAFT AUDIT REPORT'S FINDINGS AND RECOMMENDATIONS

SPP offers the following specific responses to the findings and recommendations articulated in the Revised Draft Audit Report.²³ As noted, despite the disagreement with the findings discussed below, SPP does not contest the recommendations in the Revised Draft Audit Report, with one minor exception. The purpose of these comments is to explain where the Revised Draft Audit Report has factual conclusions that SPP believes are in error.

²¹ See *Cal. Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 403 (D.C. Cir. 2004) ("CAISO") (finding that any "claimed authority to regulate all actions or activities of public utilities including the personnel and structure of its corporate governance" would have "staggering" implications).

²² *Id.* at 404; see also *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations."); *Santa Fe Indus. v. Green*, 430 U.S. 462, 479 (1977) ("Corporations are creatures of state law, and . . . except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." (quoting *Cort v. Ash*, 422 U.S. 66, 84 (1975))).

²³ The response is generally organized in the same way as the Findings and Recommendations in the Revised Draft Audit Report and uses the headings, or variations of them, as contained in the Report.

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SPP appreciates the revisions that Audit Staff has made to its findings so as to more properly characterize the activities of certain individuals as having occurred in the past, during the initial startup of the RE. These revisions properly recognize that the Regional Manager that the RE will hire will allay any concerns that activities resulting from the past organizational structure will persist.

However, SPP maintains that neither the corporation nor its staff acted in a manner that was inconsistent with the SPP Bylaws or the Delegation Agreement. The Revised Draft Audit Report incorrectly finds that the RE was not sufficiently independent from the SPP RTO or that the RE was improperly subject to the RTO's "control" during the audit period. The actions of certain individuals identified in the report were appropriately within the scope of permitted shared services and did not interfere with the independence of the RE's standards development process or the RE's oversight of the SPP RTO's compliance with reliability standards. In SPP's view, the Revised Draft Audit Report's findings should more clearly indicate that Audit Staff's concern is only that the organizational structure of SPP at certain times during the audit period may have created a *potential* to interfere with the necessary separation and independence of the SPP RE. The Report should not imply that SPP has in any way failed to comply with the Delegation Agreement or its Bylaws, which establish SPP's permitted RE structure.

OVERVIEW

SPP specifically contests and disputes the statements at the outset of the Revised Draft Audit Report (on page 1) that SPP, Inc. does "not have an adequate separation between its RTO and RE functions" and that "the RE has been heavily dependent on SPP, Inc. for staffing and largely subject to its control." The Revised Draft Audit Report does not provide evidence demonstrating that SPP, Inc. has violated the Delegation Agreement or its Bylaws, which establish the approved structure for the SPP RE. As noted above, shared services are an efficient means of operating the RE function and were expressly approved by the Commission for SPP. The Report should more clearly indicate that Audit Staff's concerns are that the organizational structure during the audit period may have provided an *opportunity* for SPP to subject the RE to its control, rather than making findings that suggest such "control" in fact existed.

Commission Orders Addressing SPP's Independence

The reference to Order No. 672 on page 4 of the Revised Draft Audit Report should more accurately reflect the holding of that order. Specifically, the reference to a "heavy burden to demonstrate a very strong separation of functions between the RTO and the RE" should be revised to track what the Commission actually found, which was that there was a burden to demonstrate "a very strong separation of *oversight and operations functions*."²⁴

²⁴ Order No. 672 at P 698.

SPP's Organizational Structure

While the Report accurately notes that the RE Trustees are envisioned as part-time positions, it should be clarified that this is consistent with corporate boards generally and therefore is not a criticism of this structure. *See* Revised Draft Audit Report at 7. The Report should more clearly reflect that the Audit Staff's concern was a lack of full-time RE management, not the part-time status of the Trustees, a concern that will be cured by the hiring of a full-time RE Manager.

Summary of Compliance Findings

SPP specifically contests and disputes the statement that the RE "was heavily dependent on the RTO for staffing" and therefore "subject to its control." *See* Revised Draft Audit Report at 11. The actions identified were permitted uses of shared services, and the dependence of the RE on such services should not be characterized as an impermissible control of the SPP RE.

Independence of RE Operations

SPP disputes the finding that Mr. Desselle and Mr. Yeung had responsibility for the RTO's compliance with NERC Standards and authority over the RE responsible for enforcing those standards. SPP also contests the following conclusion that this "dual responsibility" means that there was a lack of strong separation between the RE and RTO functions. *See* Revised Draft Audit Report at 11. While these individuals may have been involved in the design of NERC's generally applicable compliance monitoring and enforcement program, they did not participate in the "oversight" functions of the SPP RE, did not have "authority" over such RE oversight function, or otherwise compromise the RE's independent oversight function.

Further, the finding that Mr. Yeung forwarded NERC RE Managers' meeting notes to others between May and November 2007 should be clarified to state that this occurred only during the very initial transition to the RE structure. *See* Revised Draft Audit Report at 12. Mr. Yeung's actions in this regard were permissible shared services and occurred during a time when the RE function had just been initiated.

Regional Entity Board of Trustees

SPP contests the findings of the Revised Draft Audit Report that purport to evaluate and opine on the Trustees' performance of their duties. As discussed in more detail below, neither the Commission nor Audit Staff has the authority to direct the Trustees how to do their jobs. Thus, the Revised Draft Audit Report should not address the Trustees' oversight. At most, the Report should simply reflect Audit Staff's view that oversight of the RE by full-time RE *managers* was insufficient, a matter that in the future will be addressed by the hiring of a Regional Manager. To the extent the Report is not so revised, SPP specifically contests any findings suggesting that the Trustees' oversight of the RE has not been sufficient or in

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accordance with the expressly contemplated role of the Trustees under the SPP Bylaws and the Delegation Agreement.

In particular, SPP disputes the statement that the RE trustees “did not meet with RE staff often enough to assure that the RE operations were conducted with a sufficient amount of independence.” *See* Revised Draft Audit Report at 13. Neither the SPP Bylaws nor the Delegation Agreement identify a specific frequency for the RE Trustees to meet with RE staff. The frequency of Trustees meetings was fully in accord with the Bylaws, the Delegation Agreement, and the ordinary and expected functioning of a corporate board.

Similarly, SPP disputes the suggestion that the RE Trustees should be more actively involved in overseeing the RE operations. *See* Revised Draft Audit Report at 13-14. The level of involvement of the RE Trustees was fully in accord with that expected of directors.

Notwithstanding SPP’s disagreement with the findings concerning the RE Trustees’ performance, SPP understands that the hiring of a RE Manager resolves Audit Staff’s concerns. Further, SPP agrees that the RE manager and RE counsel should keep the Trustees abreast of matters affecting the RE operations, as the Report recommends.

Recommendations

Notwithstanding SPP’s disagreement with many of the factual findings in the Revised Draft Audit Report, SPP believes that it and Audit Staff fundamentally agree regarding all but one of the recommendations in the Revised Draft Audit Report. Only one of the recommendations in the Revised Draft Audit Report is not feasible to implement as currently framed. Regarding the requirement that any Registered Entity that performs functions of a Generator Operator (“GOP”) register as a GOP (Recommendation 18 on pages 17 and 48), the action recommended by Audit Staff is not the proper technique to deal with Registered Entities. This matter is discussed more fully below in Part B of this section. SPP contests this single recommendation and urges the Audit Staff to remove it from the Report.²⁵

INTRODUCTION

The reference to the Commission’s orders on page 18 of the Report should accurately reflect the actual holding of the relevant Commission orders. The reference to a “heavy burden

²⁵ The wording of the recommendation on page 16 requiring that RTO managers have no involvement in matters related to NERC and SPP RE’s compliance and enforcement policies fails to recognize an exception for processes that are generally available to the public. SPP notes that the wording of the same recommendation on page 31 (Recommendation 7) appropriately recognizes this. Presumably, the omission on page 16 is inadvertent. Otherwise, SPP also contests this recommendation for failure to allow public participation by the RTO.

to demonstrate a very strong separation of functions between the RTO and the RE” should track the language of Order No. 672 requiring only “a very strong separation of *oversight and operations functions*.”²⁶ The Commission’s order was more limited than the characterization that the Revised Draft Audit Report repeatedly gives to it.

FINDINGS AND RECOMMENDATIONS

A. SPP’s Regional Entity Has Not Operated Under the Control of the SPP RTO; At Most, it has Operated with a Structure that in the View of Audit Staff Provides the Opportunity for Control.

The hiring of a Regional Manager will eliminate any appearance of undue control of the SPP RE by the SPP RTO. There is no evidence that SPP acted inconsistently with the SPP Bylaws or the Delegation Agreement, which establish the permitted and approved organizational structure for the SPP RE. Therefore, at most, the heading of this section of the Revised Draft Audit Report should state only that SPP has operated in a manner that, in the view of Audit Staff, provides the *opportunity* for the SPP RTO to control the SPP RE.

1. SPP RE is not Impermissibly Integrated into SPP, Inc. for Managerial and Administrative Purposes

SPP disputes the characterization of a number of findings on pages 22 and 23 of the Revised Draft Audit Report. In particular, recognizing that the Commission has allowed shared services in the case of SPP, Inc., the finding that SPP, Inc. did not ensure a “sufficient separation of functions between the RTO and RE” is misleading. Any finding of a lack of separation should address only the type of separation required by the Commission orders – specifically, a separation of “oversight and operations” between the RTO and RE. In SPP’s view, no such lack of separation existed.

Notwithstanding the finding that the RE was heavily dependent on SPP, Inc.’s staffing, such dependence was appropriate as an efficient use of shared services. SPP disputes any conclusion from the use of shared services that the RE was not sufficiently independent or that any individuals acted inconsistently with the approved shared services or SPP’s Bylaws or Delegation Agreement or in any way unduly influenced the RE or exercised inappropriate control. *See* Revised Draft Audit Report at 22-23.

SPP also disputes the conclusion that Ron Ciesiel “functions as a manager” of the RTO. *See* Revised Draft Audit Report at 23. While Mr. Ciesiel may have participated in meetings with RTO managers, it does not follow that he therefore “functions as a manager” of the RTO.

²⁶ Order No. 672 at P 698.

Pertinent Guidance

The Delegation Agreement and the SPP Bylaws are the controlling documents and relevant guidance. The SPP Bylaws (which are incorporated into the Delegation Agreement) state, in pertinent part:

3.16. Certain SPP compliance monitoring functions, as detailed in section 9.0, shall be performed in concert with related ERO programs, and will be overseen by the Regional Entity Trustees.

...

9.3. The Executive Director of Compliance shall be elected by and report to the SPP Regional Entity Trustees. The President shall ensure that the Executive Director of Compliance has adequate resources, access to information, and the full cooperation of Staff and Organizational Groups for the effective execution of his/her duties.

Thus, the Bylaws expressly contemplate the sharing of SPP, Inc. services with the RE. The President of SPP is to ensure this. Further, the Bylaws establish that the Trustees will “oversee” compliance monitoring functions; they do not prohibit SPP, Inc. employees from participating in such functions.

Background

SPP maintains that the findings in the Revised Draft Audit Report constitute neither evidence of a lack of strong separation of the RE function regarding compliance matters nor a violation of any provision of the Delegation Agreement or the SPP Bylaws. The actions described were appropriately performed “shared services” promoting the efficiencies that were designed for the SPP RE, or otherwise constituted the application of normal corporate processes and controls.

SPP disagrees with Audit Staff’s concern related to Mr. Desselle’s administrative oversight over Mr. Ciesiel and Ms. Hayes. *See* Revised Draft Audit Report at 27. Administrative oversight is a permissible use of shared services – indeed, it is a primary area in which shared services are contemplated. There is no “control” involved by this proper and approved use of shared administrative services. The Report should make clear that there was no exercise of control by the proper use of shared services. At most, the Report should identify that there was an *opportunity* for undue influence presented by the arrangements.

Similarly, SPP disputes the finding that Mr. Desselle and Mr. Yeung regularly “gave orders to Mr. Ciesiel and Ms. Hayes on exclusively RE compliance matters, including deciding which NERC committee meetings they should attend.” *See* Revised Draft Audit Report at 27.

While Mr. Desselle and Mr. Yeung may have provided advice to assist Mr. Ciesiel and Ms. Hayes during the initial transition period for the RE, such input did not constitute “giving orders.” There is no evidence of any such “orders.” Nor does “Mr. Ciesiel’s deference to Mr. Desselle” when “he requested Mr. Desselle’s permission before adding a modified form of the SPP logo to the SPP Standards Development Process Manual” indicate any improper control. *See Revised Draft Audit Report at 27.* Consulting with Mr. Desselle regarding a logo is an appropriate reliance on shared services, and adherence to overall corporate policy concerning the use of the SPP logo does not interfere with the RE’s oversight function or otherwise compromise its independence.

SPP also disputes any inference of improper conduct from the finding that Mr. Desselle and Ms. Duckett briefed the trustees and the RE counsel prior to their interviews by Audit Staff. *See Revised Draft Audit Report at 27.* In an audit of SPP, Inc., the company plainly has the right, if not the duty, to discuss matters with those subject to audit interviews prior to any such interviews. The Report indicates nothing in the Commission’s rules to the contrary.

Recommendations

Notwithstanding SPP’s disagreement with the factual findings and premises for the recommendations in this section of the report, SPP concurs with the recommendations.

Recommendation 1. Hire a full-time RE manager to oversee all delegated functions of the RE and serve as its primary representative to NERC. The RE trustees should use a process independent of SPP, Inc. management to hire a full-time RE manager. (SPP, Inc. human resources staff may assist the RE in the process). *See Revised Draft Audit Report at 28.*

SPP concurs with this recommendation. As SPP informed the Audit Staff during the audit, it plans to hire a Regional Manager. Reporting directly to the RE Trustees, the Regional Manager will provide leadership and vision on behalf of the RE, oversee the execution of RE strategic direction, and direct the day-to-day operations of the RE. The Regional Manager will be responsible for the SPP RE’s success in promoting a reliable bulk power system within the region and performing the delegated statutory functions approved by the Commission and embodied in the Delegation Agreement with NERC.

Recommendation 2. Eliminate all reporting relationships between RE employees and RTO employees. This includes administrative reporting (e.g., approving time off and expense reports) as well as reporting related to performance evaluations. In addition, the RE manager must limit RE employees’ attendance at SPP, Inc. meetings to those that do not present potential conflicts, specifically those designed to address broad corporate administrative matters and career development. *See Revised Draft Audit Report at 28.*

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SPP concurs with this recommendation. RE employees will report to the RE Manager. The RE Manager will be responsible for all administrative oversight of this staff and will monitor RE employees' participation in SPP, Inc. meetings to avoid potential conflicts.

Recommendation 3. Administer RE staff performance awards independent of RTO management and staff. The RE trustees must have full control over determining the bonuses for RE employees, provided that this shall not preclude them from considering the recommendations of the SPP Human Resources Committee concerning the size of the bonus pool. See Revised Draft Audit Report at 28.

SPP concurs with this recommendation.

Recommendation 4. Establish procedures giving the new RE Manager authority to approve the RE trustees' expenses. See Revised Draft Audit Report at 28.

SPP concurs with this recommendation. The RE Manager will approve the Trustees' expenses.

Recommendation 5. Establish procedures to ensure the RE is free to offer employment to any candidate without consultation with or approval of the RTO. For candidates currently employed by SPP, Inc. the RE may cooperate with the RTO on the timing of the employee's transition to minimize disruption to RTO operations. See Revised Draft Audit Report at 28.

SPP concurs with this recommendation.

Recommendation 6. Review the RE engineering resource requirements and consider hiring additional engineering staff to perform the delegated functions of the RE. See Revised Draft Audit Report at 28.

SPP concurs with this recommendation. The Trustees recently approved the acceleration of a position budgeted for 2009 for immediate hire. This position will concentrate on the RE role in Reliability Assessments and Event Analysis. A candidate was selected and transferred to the RE in November 2008. This individual will work with the RTO engineers that traditionally have prepared the required NERC Assessments and be instrumental in writing the Assessments, interfacing with NERC, and accomplishing the RE oversight role, while shared staff will continue to address day-to-day modeling and studies efforts.

2. **RTO Employee Participation Regarding Compliance Monitoring and Enforcement Policies**

Background

SPP believes that the Revised Draft Audit Report misapplies Commission policy regarding the housing of an RTO and a Regional Entity in a single corporation. The Commission has noted that, in an arrangement where an RTO and Regional Entity operate within the same corporation, a “potential conflict” exists with respect to the Regional Entity’s enforcement of RTO compliance with reliability rules. However, the potential conflict regarding enforcement of RTO compliance does not extend to all RTO “involvement” in the development of enforcement policy generally by NERC and the RE. The opportunity for Mr. Desselle and Mr. Yeung to “influence” broader policy, *see* Revised Draft Audit Report at 29, does not present the type of conflict that the Commission identified as a concern. The general development of enforcement policy is a matter that the Commission expects will be an open process involving all stakeholders, including RTOs. There is no reason that SPP must be divorced from that process, so long as the “ultimate authority to approve and enforce proposed reliability standards” resides with the RE Trustees. *See* April 19 Order at P 397.

Thus, NERC’s asking Mr. Desselle for his opinions about reliability policy does not present any impermissible conflict. *See* Revised Draft Audit Report at 30 (referring to July 16, 2007 email). Similarly, his participation in the development of the standard CMEP to be adopted by all Regional Entities does not give rise to any impermissible conflict, particularly inasmuch as the CMEP was developed in order to be presented to FERC for approval. *See* Revised Draft Audit Report at 30 (referring to August 23, 2007 email). The emails referenced in the Revised Draft Audit Report (*see also* the April 2008 e-mails) primarily concern general enforcement policy, not the RE’s enforcement of RTO compliance with reliability rules. None of the cited emails violated any aspect of the Delegation Agreement or Bylaws or Commission policy.²⁷

The Report apparently concludes that the SPP RTO should not be involved in NERC’s deliberative process about how it will enforce compliance generally, and that NERC and SPP should not have been permitted to prepare jointly a filing before the Commission in a proceeding to which SPP was a party. *See* Revised Draft Audit Report at 31. This is unwarranted. The Delegation Agreement and Commission policy require the Trustees to have ultimate authority to

²⁷ There is no evidence to suggest that any emails withheld on the basis of privilege, *see* Draft Audit Report at 31, concerned anything other than general policy issues or the preparation of compliance filings by SPP and NERC in connection with the prosecution of the approval of the Delegation Agreement. The subject descriptions do not indicate inappropriate participation by SPP employees in approving or enforcing reliability standards.

approve and enforce reliability standards, but they do not prohibit SPP from participating in public NERC meetings, or otherwise coordinating with NERC, regarding general policy.

Finally, that a shared engineering staff employee was the RE representative to NERC's Reliability Assessment Committee presents no conflict with the Delegation Agreement or the SPP Bylaws. *See Revised Draft Audit Report at 31.* The function of the Reliability Assessment Committee is the development and publication of the Winter and Summer assessments. As engineers perform those assessments, it is appropriate that an engineer participate in the Reliability Assessment Committee. That the representatives for other REs are RE employees is irrelevant, as other REs may not have been approved by FERC to utilize shared staff. Participation of a shared employee in the committee does not interfere with the RE's function in developing and enforcing reliability standards or compliance enforcement. Nevertheless, upon the RE's hiring of an engineer, *see SPP's response to Recommendation 6*, the RE engineer will be included on the Reliability Assessment Committee roster, along with an individual who is part of shared engineering staff.

Recommendations

Notwithstanding SPP's disagreement with the factual findings and premises for the recommendations in this section of the report, SPP concurs with and will implement the recommendations.

Recommendation 7. Ensure that RTO managers have no involvement in matters relating to NERC and SPP RE's compliance monitoring and enforcement policies unless involvement relates to public matters pertaining to RE and NERC processes available to interested parties including RTOs. *See Revised Draft Audit Report at 31.*

Because the recommendation permits the RTO to continue to participate in public matters pertaining to RE and NERC processes, SPP concurs with this recommendation.

Recommendation 8. Appoint an RE staff member to represent SPP on NERC's Reliability Assessment Subcommittee and any other committee or subcommittee whose authority includes RE statutory functions. *See Revised Draft Audit Report at 31-32.*

SPP concurs with this recommendation. The NERC Reliability Assessment Subcommittee oversees the development and publication of the Summer and Winter assessments. This work is performed by shared engineering staff. As such, it is appropriate that they would participate in these meetings. SPP does not consider that participation in the development of these assessments by shared staff presents any conflict. However, the committee roster allows for one member and one alternate from each region. Upon the addition of the RE engineer noted in the response to Recommendation No. 6, SPP will assign one RE engineer and one shared engineer to the roster.

3. The RE's Budget and Expenditures

SPP maintains that its shared staff have not taken any actions that contravene the terms of the SPP Bylaws, the Delegation Agreement, or Commission policy concerning the RE's budget and expenditures. *See Revised Draft Audit Report at 32.* Notwithstanding SPP's disagreement with the factual findings and premises for the recommendations in this section of the report, however, SPP concurs with the recommendations.

Recommendations

Consistent with the balance of the Report, in the introduction to the recommendations in this section, the Report should be revised to direct the recommendation to the RE, not the RE Trustees and RE Manager.

Recommendation 9. Implement processes and procedures to ensure the RE has full authority over its budgeted spending, including RE employees' salaries and bonuses. *See Revised Draft Audit Report at 35.*

SPP concurs with this recommendation.

Recommendation 10. Implement a process to allow the RE Manager and RE trustees to approve unbudgeted expenses at the same levels that an RTO officer may approve such expense. If the RE seeks to make an unbudgeted expense that exceeds these corporate limits, the RE shall seek Commission approval for a change in its budget. *See Revised Draft Audit Report at 35.*

SPP concurs with this recommendation.

Recommendation 11. Provide that the RE manager may authorize withdrawals from the RE bank account consistent with the RE budget and eliminate SPP, Inc. management's authority to review or authorize withdrawals from the RE bank account. *See Revised Draft Audit Report at 35.*

SPP concurs with this recommendation.

Recommendation 12. Have the ability to determine the amount of funds available to the RE at anytime upon request and develop a process for addressing discrepancies resulting from an audit, bank account reconciliation, or internal reviews of the RE segregated funds. *See Revised Draft Audit Report at 35-36.*

SPP concurs with this recommendation.

Recommendation 13. Develop procedures to ensure that the independent RE Manager approves shared employees' allocation of costs to the RE. See Revised Draft Audit Report at 36.

SPP concurs with this recommendation.

Recommendation 14. Ensure that the RE reimburse the RTO for the RE trustees' 2007 travel expenses. See Revised Draft Audit Report at 36.

SPP concurs with this recommendation.

4. RE Oversight

Background

Although SPP does not contest the single recommendation in this section of the Report, the Revised Draft Audit Report's findings regarding the RE Trustees' performance of their jobs are both factually incorrect and beyond the scope of a permissible audit. The Revised Draft Audit Report criticizes the RE Trustees for having allegedly "limited involvement" with the SPP RE Staff and for being "unaware of several important issues." See Revised Draft Audit Report at 35. These findings fail to appreciate the role of Trustees, and they exceed the proper scope of an audit as well as the authority of the Commission.

As discussed earlier in this response, the Commission may regulate the activities of SPP and the RE, but it should not direct how the Trustees individually perform their fiduciary obligations or how they acquire the necessary knowledge to carry out their functions. These are matters of state law, which permits the Trustees to exercise their sound business judgment in performing their duties. It is inappropriate for Audit Staff to address the Trustees' performance of their jobs or the adequacy of their knowledge.²⁸

While the Revised Draft Audit Report finds that the Trustees have "little" contact with RE staff aside from formal meetings, such limited contact is entirely consistent with the functioning of a corporate board, which oversees but does not manage an organization. The Revised Draft Audit Report appears to suggest that the role of the Trustees in hiring decisions was too limited (see Revised Draft Audit Report at 36-37), but the Trustees fulfilled their specific duty to approve all hiring, and they did so after interviewing the candidates they hired. The extent to which the Trustees should consider one or more candidates, or utilize an outside consulting firm, is not within the prerogative of either the Commission or Audit Staff, but rather resides within the sound business judgment of the Trustees.²⁹ Similarly, the extent to which

²⁸ See notes 21-22, *supra*.

²⁹ The Draft Audit Report's reference to an email from Ms. Duckett to the Trustees as evidence of the RTO's influence over the Trustees also lacks any probative value. See (continued...)

Trustees determine they must familiarize themselves with specific matters is within the sound discretion of the Trustees. The Revised Draft Audit Report's findings regarding the Trustees' alleged unawareness of "some" issues "germane to their responsibilities" reference only a few relatively inconsequential matters such as one Trustee's not knowing precisely some of Mr. Desselle's functions for the RTO. *See* Revised Draft Audit Report at 38. These findings are not probative of SPP's compliance with its Bylaws or the Delegation Agreement, and their inclusion in the Revised Draft Audit Report is inappropriate.

While the Revised Draft Audit Report finds that the Trustees have little "day-to-day" involvement, *see* Revised Draft Audit Report at 37-38, that is precisely how a Board of Trustees is supposed to function. Day-to-day affairs are managed by the staff of an organization, not its trustees. Mr. Christiano's statement that the Trustees "don't do hands-on supervising" is entirely consistent with the role of a Board of Trustees.

That Mr. Ciesiel had daily communications with Mr. Desselle, *see* Revised Draft Audit Report at 38, reflects only that SPP and the RE use shared staff, which the Delegation Agreement specifically contemplates. It does not in any way evidence that the Trustees' involvement with Mr. Ciesiel is insufficient. Further, Mr. Yeung correctly told Audit Staff that he reports only to Mr. Desselle. *See* Revised Draft Audit Report at 38. The fact that he is performing shared services does not affect who he reports to. Shared services employees do not report to the Trustees directly; nor should they. Shared employees assist in accomplishing RE tasks, but they continue to report to their respective supervisors. This is the design of shared services, and does not reflect any noncompliance by SPP with the Delegation Agreement.

In sum, none of the findings in this section demonstrates a failure by the Trustees to exercise their "ultimate authority to approve and enforce proposed reliability standards"³⁰ or any other provision of the Delegation Agreement or Bylaws. To the extent that Audit Staff has concerns regarding the oversight of RE operations, the Report should indicate that these concerns stem from the lack of a full-time RE Manager, not the performance of the Trustees. The concern will be addressed by the hiring of a full-time RE Manager, and SPP agrees to provide a detailed response explaining how the RE Manager and RE counsel plan to keep the RE Trustees informed.

(...continued)

Revised Draft Audit Report at 36-37. Ms. Duckett's email simply advised the Trustees that they needed to take the formal corporate action of electing the Director of Compliance, as required by the Delegation Agreement and the Bylaws; there is no evidence cited, from contemporaneous documents or audit interviews, suggesting anything to the contrary. Indeed, the Trustee interview that is cited notes that SPP recommended, not directed, the hire in question. Chairman Meyer also specifically explained why he hired the individual; there is no basis to question the Trustees' judgment in this regard. *See* Revised Draft Audit Report at 37.

³⁰ *See* April 19 Order at P 397.

Recommendations

Recommendation 15. Provide a detailed written response explaining how the RE manager and RE counsel plan to keep the trustees better informed of important matters affecting the RE operations. See Revised Draft Audit Report at 39.

Notwithstanding SPP's disagreement with the factual findings and premises for the recommendation in this section of the report, SPP concurs with this recommendation.

5. Confidential Compliance Information

Background

Regarding the findings addressing the sharing of compliance information on page 40 of the Report, SPP emphasizes that many of the cited actions occurred before or just after the launch of the RE. The findings regarding Mr. Yeung's participation in NERC Board of Trustees Compliance and NERC Managers meetings through November 2007 and the forwarding of his notes regarding those meetings should recognize the transitional nature of Mr. Yeung's participation. With respect to the NERC Managers meetings, any finding should recognize that the subject matter "interpretation of standards" referred to the "generally applicable interpretation of standards," not matters regarding specific RE compliance monitoring.

Recommendations

Recommendation 16. Develop procedures to ensure that RTO managers and employees are prevented from receiving confidential compliance information and that RTO employees are permitted access to RE offices only when necessary to perform shared RE functions and when accompanied by RE staff. These procedures should include a non-disclosure agreement that shared staff must sign pledging not to reveal confidential RE information. See Revised Draft Audit Report at 43.

SPP concurs with this recommendation.

B. Implementation of the Compliance Monitoring and Enforcement Program

SPP concurs with the recommendations in this section of the Revised Draft Audit Report, with the exception of Recommendation 18.

Recommendations

Recommendation 17. Require detailed completion schedules for all mitigation plans. See Revised Draft Audit Report at 48.

SPP concurs with this recommendation.

Recommendation 18. Require any registered entity that performs functions of a GOP to register as a GOP. See Revised Draft Audit Report at 48.

The action recommended is not the proper technique to deal with Registered Entities. The practice established by NERC is that the Regional Entity ascertains a viable party to be the Registered Entity for a specific function, and it becomes the entity *responsible* for compliance performance. The fact that another entity actually performs activities in support of the compliance program does not shift the compliance responsibility from the Registered Entity to the performing entity. There are dozens of examples in the current NERC Compliance Registry where the Registered Entity does not perform all of the monitored activities, but is held responsible for the results. Only in rare cases where multiple entities cannot agree on responsibilities will a Regional Entity be forced to register both parties in order not to create a gap in coverage. This usually occurs where there are multiple owners of a facility, no party has been designated as the managing partner, and no party is willing to assume the responsibility and risk of being the Registered Entity. Therefore, SPP urges the Audit Staff to reconsider this recommendation and remove it from the Report.

Recommendation 19. Work with NERC and the other REs to develop a written policy on extending self-certification deadlines. See Revised Draft Audit Report at 48.

SPP concurs with this recommendation.

Recommendation 20. Develop procedures to ensure the RE staff obtain corroborating evidence to verify a registered entity's compliance following a self report. See Revised Draft Audit Report at 48.

SPP concurs with this recommendation.

Recommendation 21. Ensure that NERC performs all audits of SPP, Inc.'s registered entity functions (Reliability Coordinator, Transmission Service Provider, Transmission Planner, Reserve Sharing Group and Planning Authority), including all facets of these audits, from audit commencement and pre-audit survey to final audit report. See Revised Draft Audit Report at 48-49.

SPP concurs with this recommendation.

Mr. Bryan K. Craig
December 10, 2008
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IV. CONCLUSION

SPP is pleased that it and Audit Staff have been able to resolve Audit Staff's concerns through the recommendations contained in the Revised Draft Audit Report. SPP's foregoing response is intended to address factual matters with which SPP cannot agree and therefore must contest. Despite the disagreement with some of the factual premises for the recommendations, SPP does not contest the recommendations themselves, with the single exception discussed above. SPP remains open to discussing these matters with Audit Staff prior to the submission of this response to the Commission and the issuance of a final report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Barry S. Spector". The signature is fluid and cursive, with a large initial "B" and "S".

Barry S. Spector
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