151 FERC ¶ 61,225
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Philip D. Moeller, Cheryl A. LaFleur,
Tony Clark, and Colette D. Honorable.

North American Electric Reliability Corporation | Docket No. RR15-8-000

ORDER CONDITIONALLY ACCEPTING REVISIONS TO WORKING CAPITAL AND OPERATING RESERVE POLICY

(Issued June 18, 2015)

1. On March 6, 2015, North American Electric Reliability Corporation (NERC) filed proposed revisions to its Working Capital and Operating Reserve Policy (Reserve Policy). As discussed below, we conditionally accept NERC's proposed revisions to the Reserve Policy, subject to NERC submitting a compliance filing within 60 days of the date of this order.

I. Background

2. On August 22, 2011, the Commission's Office of Enforcement informed NERC by letter that it was commencing a performance audit of NERC pursuant to section 215 of the Federal Power Act (FPA).[1] The audit commencement letter stated that the performance audit would evaluate "NERC's budget formulation, administration, and execution[,] . . . will focus on the costs and resources used to achieve program objectives . . . [and] will cover the period from August 23, 2006 to the present."[2]

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[1] 16 U.S.C. § 824o (2012).

[2] The Office of Enforcement's August 22, 2011 letter is available through the Commission's eLibrary document retrieval system in Docket No. FA11-21-000.

3. On May 4, 2012, the Office of Enforcement issued its performance audit report (Audit Report) by delegated letter order.[3] The Audit Report outlined 42 recommendations to remedy the audit findings and enhance performance of NERC's budget process. Specifically, Recommendation Nos. 1 and 2 recommended that NERC do as follows:

> 1. Establish more robust procedures and controls over NERC's use of working capital reserves.
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> 2. Develop a transparent process that permits the Commission, the [Board of Trustees (Board)] and stakeholders opportunity to review the expenditure of funds approved for specific statutory activities to be redirected to unbudgeted activities, and develop and obtain Board approval of enhanced guidelines governing such expenditures, including criteria for determining when Board and Commission approval is required.[4]

4. On August 24, 2012, in accordance with Audit Recommendation No. 1, NERC submitted the Reserve Policy, governing its working capital and operating reserves, in Exhibit E of NERC's 2013 business plan and budget filing.[5] The Commission accepted the Reserve Policy as part of NERC's 2013 business plan and budget filing, on November 2, 2012.[6]

5. On January 16, 2013, the Commission approved a settlement between NERC and the Office of Enforcement regarding the audit findings.[7] The Settlement Agreement, *inter alia*, modified Recommendation No. 2 regarding NERC's Reserve Policy, by modifying the language of the recommendations and adding sub-requirements.[8]

6. Specifically, *inter alia*, revised Recommendation No. 2 requires NERC to "file for Commission review and approval … proposals to expend $500,000 or more from

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[3] *North American Electric Reliability Corp.*, Docket No. FA11-21-000 (May 4, 2012) (delegated letter order) (Audit Report Letter Order).

[4] Audit Report Letter Order, Audit Report at 7, 28-29.

[5] NERC, Petition, Docket No. RR12-13-000 (filed Aug. 24, 2013).

[6] *North American Electric Reliability Corp.*, 141 FERC ¶ 61,086 (2012).

[7] *North American Electric Reliability Corp.*, 142 FERC ¶ 61,042 (2013).

[8] *Id.*, Settlement Agreement at P 7.

operating reserves designated for 'unforeseen contingencies.'"[9] The Settlement Agreement stipulates that the need for Commission review and approval is triggered if any amount allocated from the unforeseen contingencies account of operating reserves plus any amount re-directed from previously budgeted funds is, in the aggregate, $500,000 or more for any one specific project or major activity in a program area.[10] The Settlement Agreement also requires NERC to file any proposed revisions to its Reserve Policy for Commission review and approval.[11]

7. On August 23, 2013, NERC submitted its 2014 business plan and budget for Commission approval. On November 1, 2013, while generally approving NERC's filing, the Commission, *inter alia*, rejected NERC's proposal to allocate to "restricted working capital" $3.8 million to offset future liabilities regarding lease agreements and directed NERC to submit a compliance filing concerning how it would allocate the $3.8 million consistent with its Reserve Policy.[12] In a compliance filing, NERC revised its Reserve Policy to further define working capital as "cash balances reasonably necessary to meet current and future obligations under any covenant, financial, or other obligation under the terms of any loan, credit, or lease agreement." NERC's compliance filing was accepted on January 3, 2014.[13]

II. Petition

8. NERC proposes to revise the Reserve Policy to include the following operating reserves: (1) future obligation reserve, (2) system operator certification reserve, (3) Cybersecurity Risk Information Sharing Program (CRISP) reserve, and (4) operating contingency reserve. NERC's revisions to the Reserve Policy also include the addition of

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[9] *Id.* P 7(b)(ii).

[10] *Id*.

[11] *Id.* P 7(d) ("The provisions of Section 7(a), (b), and (c) are based on NERC's current Reserve Policy, which, *inter alia*, defines 'working capital reserves,' 'operating reserves,' 'known contingencies' and 'unforeseen contingencies.' NERC will file proposed revisions to the Reserve Policy that would alter any of those definitions, or would change the Reserve Policy's requirement that all excess funds be added to the unforeseen contingency operating reserves and expended in accordance with the Policy's unforeseen contingency guidelines, for Commission review and approval.").

[12] *North American Electric Reliability Corp.*, 145 FERC ¶ 61,097, at P 23 (2013).

[13] *North American Electric Reliability Corp.*, Docket Nos. RR13-9-001 and RR13-9-002 (Jan. 3, 2014) (delegated letter order).

an assessment stabilization reserve.[14] NERC maintains that the proposed categories reflect changes in NERC programs, eliminate unnecessary components, merge old reserve categories, and establish a new assessment stabilization reserve.[15]

9. NERC proposes to revise the Reserve Policy's definition of "working capital" so that it no longer includes "cash balances reasonably necessary to meet current and future obligations under any covenant, financial, or other obligation under the terms of any loan, credit, or lease agreement to which the company is a party," and, instead, establish the future obligation reserve for such needs. NERC states that funds to satisfy future contractual or covenant obligations are not needed to satisfy daily cash flow requirements and are more appropriately classified as a reserve. NERC proposes to define "working capital" as only funds needed to satisfy cash flow requirements throughout the year, while operating reserves will consist of reserves needed to support operations, including contractual and covenant obligations, as well as contingencies.[16]

10. NERC proposes to create an assessment stabilization reserve to mitigate year-to-year swings in assessments, which can result from a variety of factors, such as application of penalty funds collected, surplus funds available from a prior period, a need to replenish the operating contingency reserve, or significant but relatively short-term operating or capital spending needs.[17] NERC states that the goal of the reserve is to have changes in annual assessments track, within a reasonable band, changes in NERC's total annual budget, with the total budget reflecting prudent fiscal discipline and good stewardship of resources. NERC asserts that funds from the assessment stabilization reserve may not be used for any purpose inconsistent with the goal of the reserve except as otherwise approved by the Board.[18] NERC states that this provision provides additional flexibility for the Board in extreme and highly unusual circumstances in a particular year, such as an unexpected and significant litigation expense or a significant Bulk-Power System event that requires extraordinary investigation expenses.[19]

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[14] NERC Petition at 1-2; Revised Reserve Policy at 1.

[15] NERC Petition at 1-2.

[16] *Id.* at 5.

[17] NERC Petition at 8; Revised Reserve Policy at 2.

[18] *Id.*

[19] NERC Petition at 8.

11. With regard to the assessment stabilization reserve, NERC requests an exception pursuant to §1107.4 of the NERC Rules of Procedure. NERC notes that Rules of Procedure §1107.2 requires the use of penalty funds as a general offset to NERC's budget requirements for the subsequent fiscal year, but notes that §1107.4 provides that "Exceptions or alternatives to the foregoing provisions will be allowed if approved by NERC and by FERC or any other Applicable Governmental Authority."[20] NERC requests an exception such that it may place penalty funds received prior to July 1 of a year into the assessment stabilization reserve, to be applied in a future budget to mitigate assessment volatility, rather than using the penalty funds as a general offset to NERC's budget requirement for the subsequent fiscal year. NERC indicates that these funds will continue to be used to reduce assessments, but in a future period rather than the next budget year.

12. NERC proposes to establish lower and upper bounds on operating contingency reserve levels equal to 3.5 percent and 7.0 percent, respectively, of NERC's total budgeted expenditures, excluding the CRISP and system operator certification reserves. NERC states that these bounds are intended to provide a reasonable "bandwidth" around the funding amount for operating contingency reserve.[21]

13. NERC proposes to increase the levels of expenditures from operating reserves that must be approved internally (i.e., by the NERC president and chief executive officer (CEO), the Finance and Audit Committee of the Board, and the Board itself). NERC's proposed revisions double each expenditure limit currently required for review by its respective levels of management or oversight. NERC notes that, because the current language referring to "known contingencies" and "unknown contingencies" is being replaced by the proposed operating contingency reserve category, NERC will treat the "unforeseen contingencies" references in Paragraph 7(b)(ii) of the Settlement Agreement as encompassing expenditures from the proposed operating contingency reserve.[22]

14. NERC proposes to eliminate the requirement that budgeted but unspent funds from a budget area be transferred to the unforeseen contingency operating reserve before the president and CEO can expend such funds in other budget areas. NERC's proposed language, instead, gives authority to the president and CEO to reallocate and expend those unspent funds elsewhere so long as NERC's overall approved budget is not exceeded and such expenditures are reported to the Finance and Audit Committee and

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[20] NERC Petition at 10-11.

[21] *Id.* at 12.

[22] *Id.* at 15.

submitted in NERC's quarterly variance reports to the Commission.[23] NERC reiterates that any such expenditure and reallocation also will be subject to the Commission filing and approval requirements under Paragraph 7(b)(ii) of the Settlement Agreement if the dollar amount exceeds $500,000.[24]

15. NERC proposes to eliminate the provision in the Reserve Policy regarding review and approval requirements when attempting to add unbudgeted full-time equivalent employees (FTE) or headcount additions beyond what was budgeted for a particular fiscal year, regardless of the source and availability of funding. NERC states that this proposed change is appropriate because increases in its FTEs and headcount are not directly related to the management of operating reserves and are not appropriately included in the Reserve Policy. NERC states that if an increase in FTEs or headcount during a year above the budgeted levels requires either the expenditure of funds from an applicable reserve category or the reallocation of funds from one budget area to another, then the Reserve Policy provides for the appropriate review, approval, and reporting of the expenditures. NERC also contends that the quarterly variance reports that NERC submits to the Commission include information on actual versus budgeted FTEs.[25]

III. Notice of Filing

16. Notice of NERC's March 6, 2015 filing was published in the *Federal Register*, 80 Fed. Reg. 13,528 (2015), with interventions and protests due on or before March 27, 2015. No protests or interventions were filed.

IV. Discussion

17. We conditionally accept NERC's proposed revisions to the Reserve Policy, subject to NERC submitting a compliance filing within 60 days of the date of this order, as discussed below.

18. In its filing, NERC represents that any reallocation and expenditure of budgeted but unneeded funds would be subject to Paragraph 7(b)(ii) of the Settlement Agreement.[26] Further, NERC notes that the assessment stabilization reserve would only be used as approved by the Commission in NERC's business plan and budget filings,

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[23] *Id.* at 16; Revised Reserve Policy at 4.

[24] NERC Petition at 16.

[25] *Id.* at 20.

[26] *Id.* at 16.

except in extraordinary cases.[27] We expect that any extraordinary use of assessment stabilization reserve funds would also be subject to the limits and filing requirements under Paragraph 7(b)(ii) of the Settlement Agreement. We note, however, that such requirements are not articulated in the revised Reserve Policy. Thus, we direct NERC to submit a compliance filing within 60 days of the date of this order proposing revisions to the Reserve Policy to clarify that any reallocation and expenditure of budgeted funds, including from the assessment stabilization reserve, is subject to the requirements of Paragraph 7(b)(ii) of the Settlement Agreement.

19. While we accept, subject to the condition above, the proposed revisions to the Reserve Policy with regard to the assessment stabilization reserve, we find NERC's request for an exception regarding the use of penalty funds pursuant to NERC Rules of Procedure §1107.4 premature. Rather than providing a blanket exception, we find that any such exception is more appropriately addressed on a case-by-case basis, such as in NERC's annual business plan and budget submissions. In its petition, NERC represents that it may only request to inject into or withdraw funds from the assessment stabilization reserve through its annual business plan and budget submissions.[28] Thus, an exception under Rules of Procedure §1107.4 is not ripe in this proceeding. The Commission will consider the appropriateness of granting an exception under Rules of Procedure §1107.4 based on the specifics of each request by NERC in any future business plan and budget submission.

20. Finally, we note that NERC must continue to seek Commission approval of any future proposed changes to the NERC Reserve Policy as required by Paragraph 7(d) of the Settlement Agreement.

<u>The Commission orders</u>:

(A) NERC's proposed revisions to the Reserve Policy are hereby conditionally accepted, as discussed in the body of this order.

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[27] *Id.* at 8-9.

[28] *Id.* at 9 ("any injection of funds into the Assessment Stabilization Reserve … or withdrawal of funds … [will be] subject to approval by the NERC Board and, ultimately, by the Commission as part of its approval of that year's business plan and budget").

(B) NERC is hereby directed to submit a compliance filing within 60 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.