Elements of Robust Compliance Program
FERC’s Views as Revealed through
NERC Reliability Standards

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Sempra Energy Utilities: Who are we?

Sempra Energy – San Diego, CA Based
– Fortune 500 energy services holding company
– 2014 revenues of more than $11 billion
– $23.95 Billion Market Capital
– The Sempra Energy companies’ 17,000 employees
  serve more than 32 million consumers worldwide.

San Diego Gas and Electric
– Serves 3.4 million customers in San Diego & Southern
  Orange Counties through 1.4 million electric and
  870,000 gas meters

SoCalGas®
– nation’s largest natural gas distribution utility
– serves more than 20 million consumers across 20,000
  square miles throughout central and Southern
  California.

SDG&E’s Registered NERC Functions:
Transmission Owner (TO)
Transmission Operator (TOP)
Transmission Planner (TP)
Generator Owner (GO)
Generator Operator (GOP)
Distribution Provider (DP)
Resource Planner (RP)
The views expressed in this presentation are those of the presenters and do not necessarily represent the views, opinions or position of SDG&E, SoCalGas or Sempra Energy.

The Two Types of Rules and Regulations

- **Proscriptive Rules**
  - Rules that prohibit certain actions or behavior
    - Anti-Market Manipulation
    - Anti-Bribery and Corruption
- **Prescriptive Regulation**
  - Requires the performance of various tasks, activities, or practices
    - NERC Reliability Standards
    - PHMSA Pipeline Safety Regulations
    - Public Utility Commission General Orders – Construction and Maintenance

NERC Reliability Standards define the reliability requirements for planning and operating the North American bulk power system

- There are over 130 NERC Standards
- Over 1300 Requirements
Subject to Enforcement by FERC
“Right Sizing” Compliance Program

• This discussion will focus on the elements of a robust compliance program for what regulators consider a key risk; the reliability of the nation’s Bulk Power System

• Essential for companies to develop a program that matches the risk that is addressed by the laws, rules or regulations.

• Low risk areas will require fewer elements

• Make sure your assessment of risk matches that of the regulator or other “rule enforcers”

• Pick and choose what makes sense for your entities risks

Essential Compliance Program Elements

• Guidelines
  – FERC issued Statement of Enforcement and Statement on compliance after the passage of EPAct in 2008 recommending companies adopt a formal compliance program that provided high-level guidance

• Specific Requirements
  – FERC, in adopting NERC Reliability Standards required very specific elements in a robust compliance program

• Implementing NERC Compliance Programs
  – FERC and NERC expectations as revealed through audits, self-certifications, enforcement actions, etc. reveal tangible, strong compliance plan criteria
FERC: Hallmarks of an Effective Compliance Program

• **Management Involvement**: Active leadership and engagement by executives and other senior management engagement demonstrates commitment to compliance.

• **Effective Preventive Measures**: Effective measures designed to prevent non-compliance from occurring. This includes effective accountability for compliance and periodic review and evaluation of the effectiveness of the program.

• **Detective Measures**: Proactive capabilities to detect problems, identify the problem, misconduct or other actions that result in a violation, and the prompt reporting of a violation as appropriate;

• **Remediation Program**: Operative practices to promptly ensure prompt mitigation or remediation of identified areas of violation or misconduct and the implementation of measures to ensure nonrecurrance.

Explicit Delegation of Responsibility

• NERC’s Critical Infrastructure Protection (CIP) require the designation of a “senior manager” responsible for compliance with those standards
  – the standards require that the scope of the delegation and the regulations and laws that are covered are clear and specific

• FERC repeatedly cited SDG&E’s NERC Compliance Program use of a “designated leader” as a mitigating factor in assessing violations
  – SDG&E includes a table of responsibility that clarifies who which employee, manager, director and officer is responsible for compliance with each requirement/sub-requirement.

• Compliance supervised by an officer or other high-ranking official
  – See FERC Statement on Enforcement, Paragraph 58
Specific, Accessible Regulations

- Clear list of the laws and regulations to be complied with, an inventory of current compliance risks
  - See FERC Statement of Enforcement – Paragraph 59
  - This will result in a list of current program requirements
- NERC facilitates this by publishing a single document which lists all Standards in one place and each standard states which entities it is applicable to.
- Internal responsibility matrices that clearly list the specific compliance responsibilities.

Formal Compliance Program

- Recommend written Internal Compliance Plan (ICP) that is reviewed periodically and updated as needed.
- Voluntary ICP reviewed by regulator periodically
- ICP published & communicated internally to impacted employees
- FERC reviews the ICP and assesses its quality in consideration of mitigating factors when evaluating penalties and other sanctions.
- Compliance plan must be actively implemented and its elements followed and monitored.
Auditable Compliance: Clear and Convincing Documentation of Compliance

• NERC requires adequate documentation of compliance be developed and archived
  – Requires timely ability to provide that documentation in a timely fashion
  – Documentation and evidence should be reviewed for sufficiency prior to archiving for future use.
• Requires that documentation be presented in a clear format with a narrative that explains how the evidence demonstrates compliance
  – NERC Developed Reliability Standards Audit Worksheets to facilitate presentation of the documentation
  – Evidence is only as strong as the narrative that introduces it. Must explain what requirement it is intended to prove compliance, what the evidence demonstrates and how it demonstrates
  – Subject Matter Experts understands what the documentation proves, how it proves it, and can describe this well to auditors and regulators.

Self Regulation is Key

• NERC Requires an Annual Self-Certification
  – NERC and Regional entities require that utilities certify that they were compliant for the entire year for specific standards and requirements
  – NERC and Regional Entities are using review of self-certification documentation in lieu of in-depth audits for some utilities based on a risk assessment
• Entities that discover potential violations must self-report and develop their own mitigation plans subject to approval.
  – Ongoing process for auditing compliance with Commission regulations (Statement of Enforcement, Paragraph 58)
  – FERC outlines the importance on good-faith self-reporting (Statement on Enforcement Paragraph 62)
• Violations discovered during compliance audits are treated more severely than those that are self-reported.
Keys to Self Regulating

- Self-regulation is not “unregulated” or “lessened oversight” or “unenforced”
- Annual Self-Certification
  - Recommend internal self-certification to all standards based
  - Require review and verification of compliance more broadly than required “self certifications”.
- “Trust but Verify” philosophy and processes, don’t rely solely on attestations of compliance, review of documentation of compliance is key
  - Third party auditor/reviewer
  - Internal Audit
  - Internal independent compliance organization
  - Peer Review
  - Management Review
- Regular mock audits by outside consultants is a best practice

Recent Developments: FERC/NERC Risk-Based Approach

- Regulators see risk as the risk to society not risk to the company
  - Inherent Risk = Potential impact to society X likelihood of event
  - Risk mitigation reduces impact or likelihood or both
  - Risk to society cannot be shifted, only compensated for
- Risk based compliance does not mean risk of being out of compliance, but rather the risk that being out of compliance places on society
  - Compliance Risk = Risk that the mitigation of risk is compromised due to failure to comply with laws, rules or regulation
  - High Risk = greater oversight, stiffer penalties, stronger mitigation

Risk Element Identification (REI)

“regularly identify and prioritize ERO-wide risks to reliability based on significance, likelihood, vulnerability and potential impact to the reliability of the [Bulk-Power System]” (150 FERC ¶ 61,108, P 9)
Recent Developments: Risk-Based Compliance Monitoring

- Inherent Risk Assessments (IRA)
  - Entity profile - potential risks posed by an individual entity to the reliability of the Bulk-Power System: Considers factors such as assets, system, geography, interconnectivity, prior compliance history and factors unique to the entity.

- Internal Control Evaluation (ICE)
  - Entity’s internal controls that detect, correct, and mitigate the entity-specific identified risks

- Evidence vs. Controls: NERC’s Risk based approach focuses on evaluation of controls to focus audit’s examination of specific evidence of compliance
  - Key controls
  - Mitigating controls

- Audit Risk = Inherent Risk x Control Risk x Detection Risk