

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

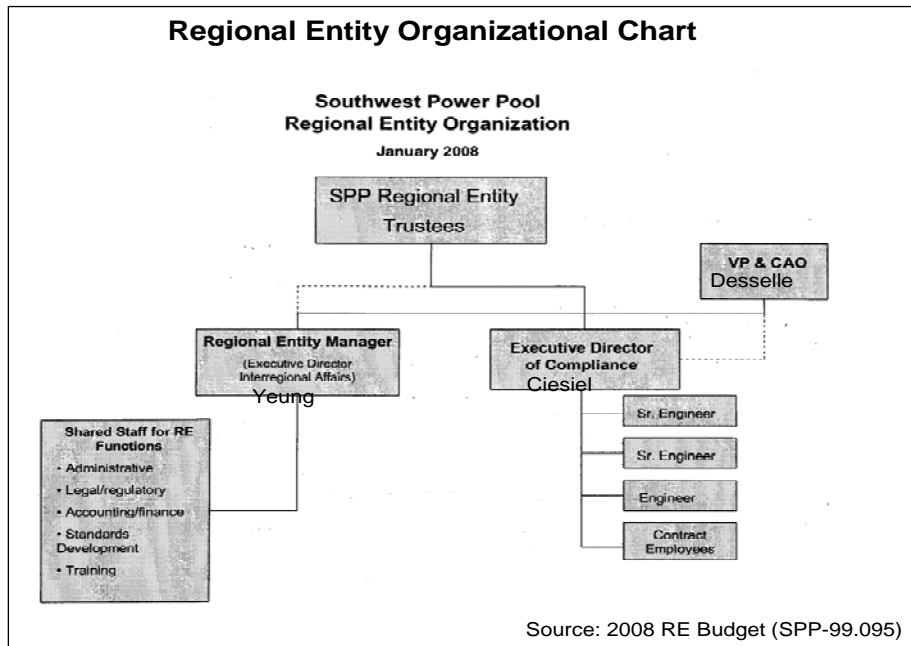
¹⁶ *March 21, Order at P 212.*

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

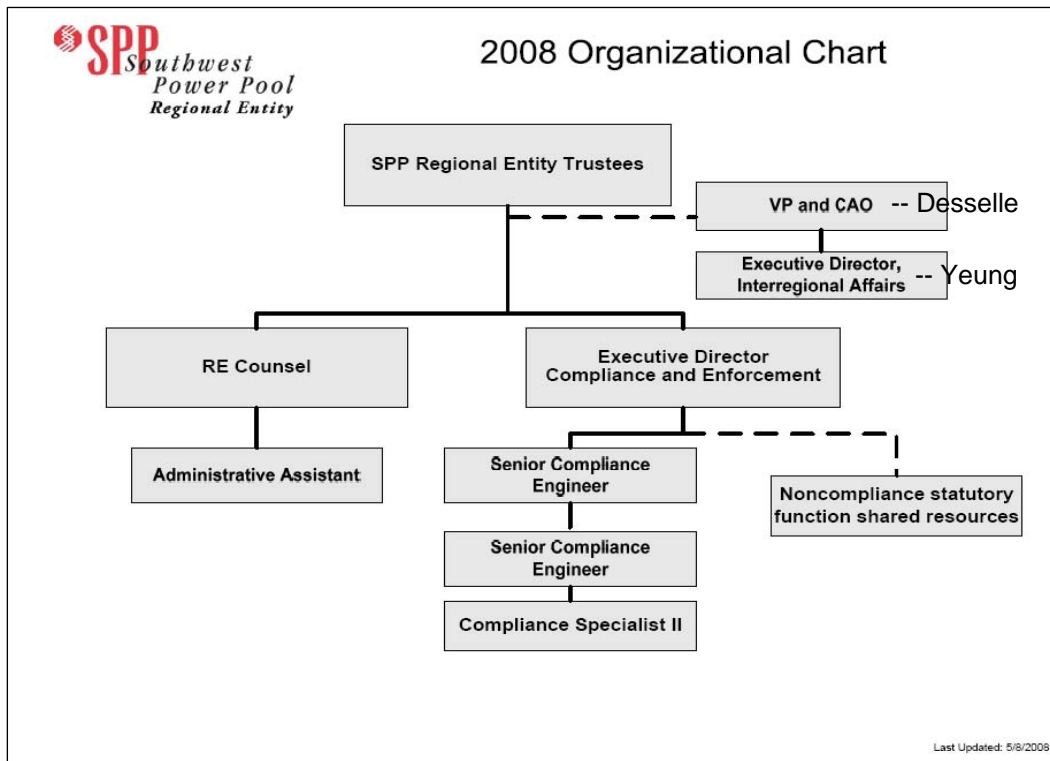


¹⁸ Names were added below titles for clarity.

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



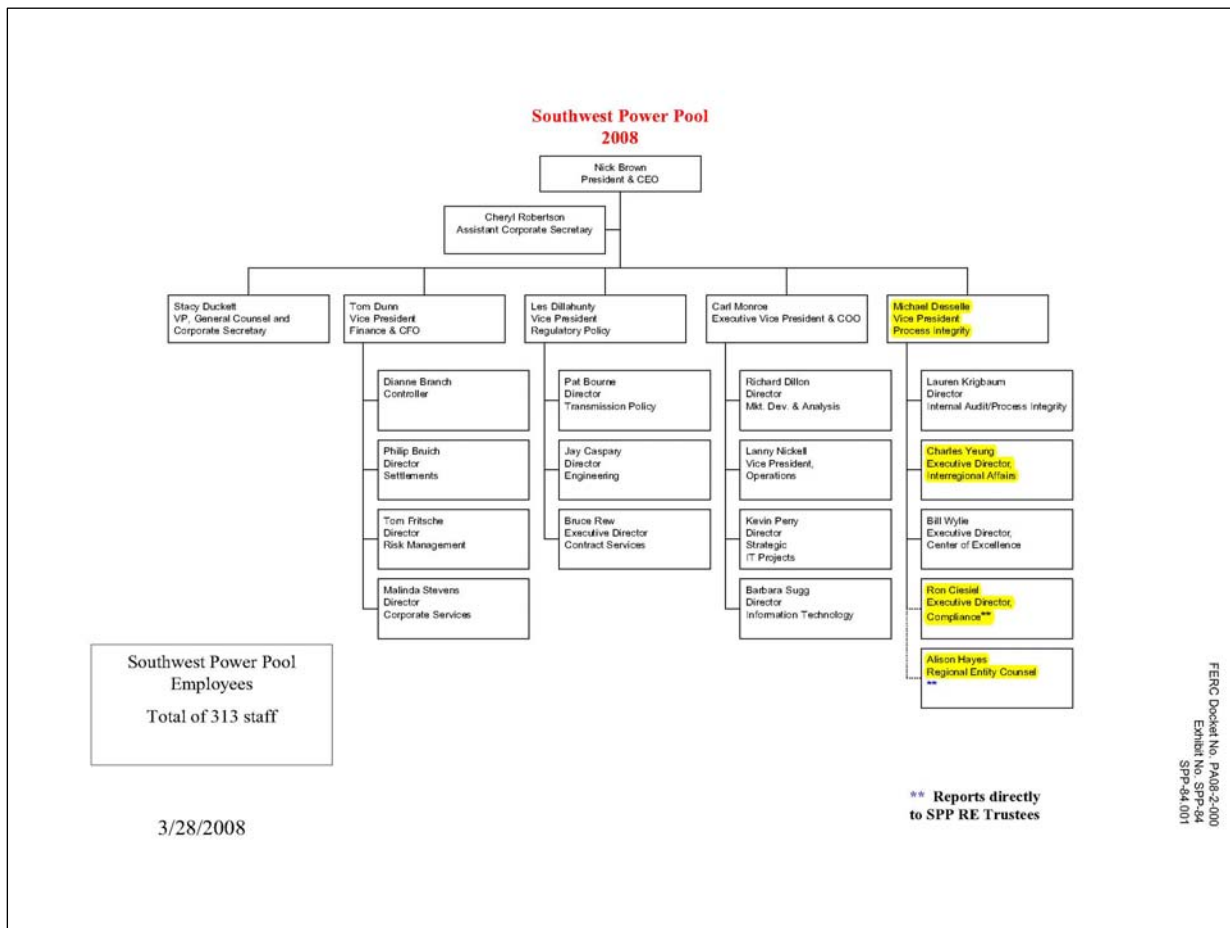
²⁰ Minutes of the January 30, 2008 RE Trustees meeting list as an Action Item: “Revise RE organizational chart to reflect a dotted line from Ron to Noncompliance Statutory Function Shared Resources and make sure line is dotted between RE Trustees and Michael and Charles. Put chart on website.” The minutes 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

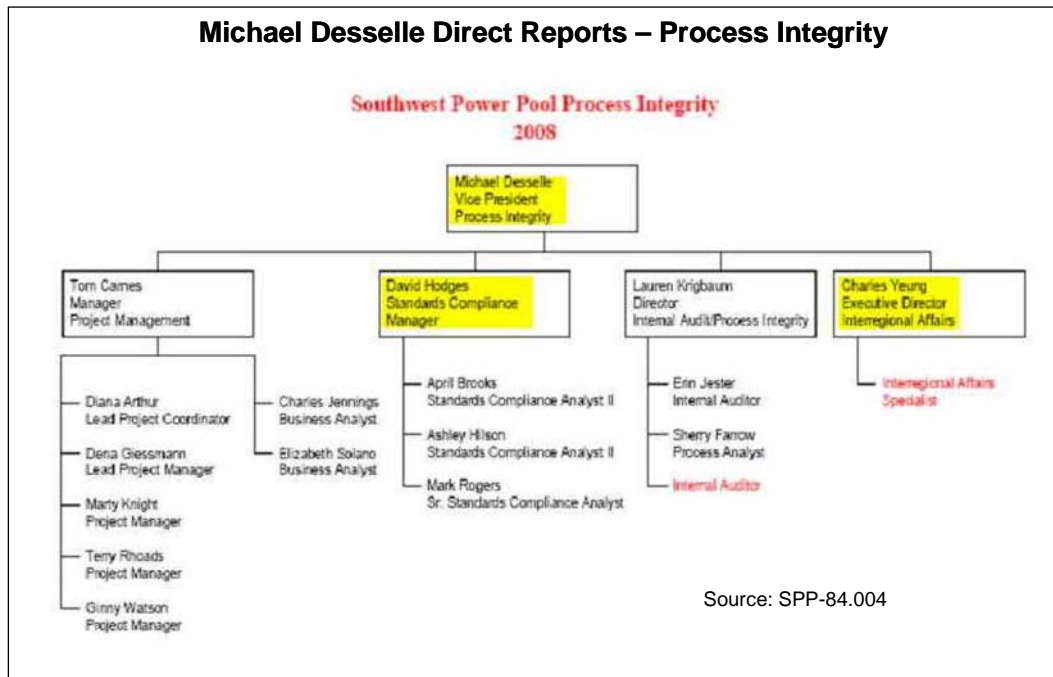


Figure 5

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).

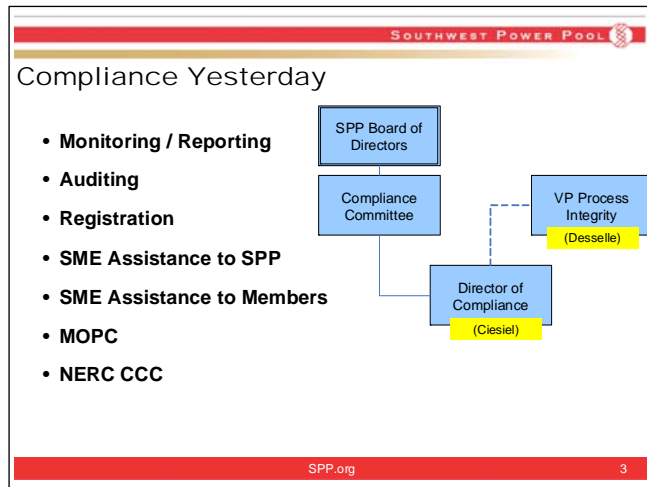


Figure 6

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).

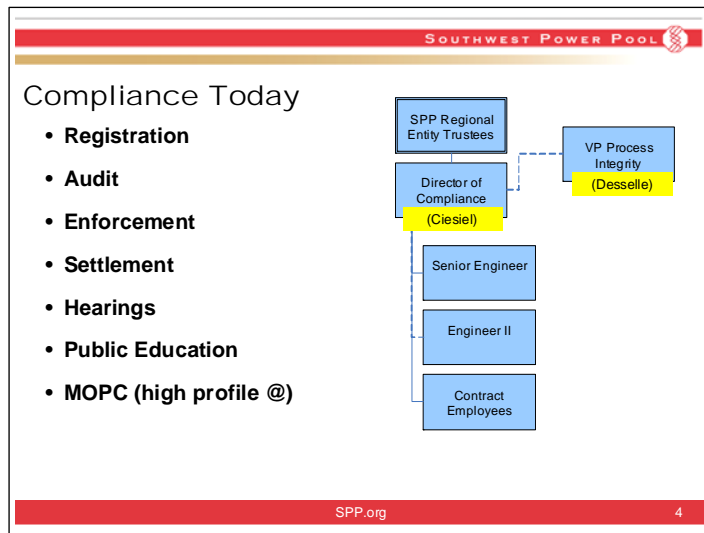
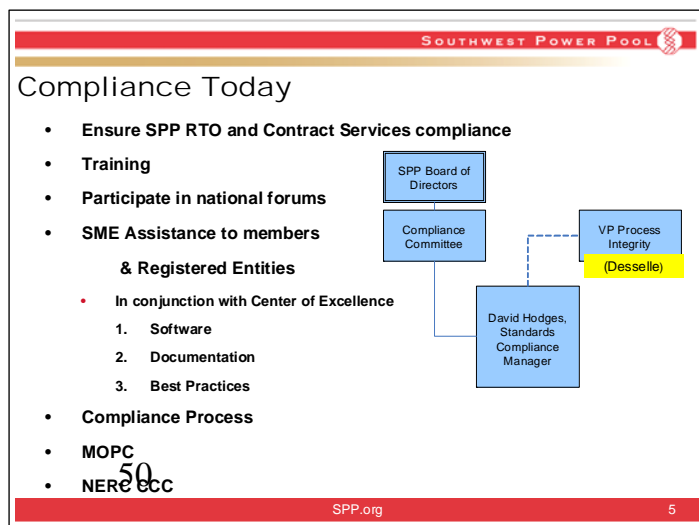


Figure 7



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.