

March 6, 2015

**VIA ELECTRONIC FILING**

Ms. Kimberly D. Bose  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

**Re: North American Electric Reliability Corporation  
Docket No. RR15-\_\_\_\_-000  
Request for Approval of Revisions to NERC's Working Capital and Operating  
Reserve Policy**

Dear Ms. Bose:

The North American Electric Reliability Corporation (NERC) hereby submits the "Request of the North American Electric Reliability Corporation for Approval of Revisions to its Working Capital and Operating Reserve Policy."

NERC's filing consists of: (1) this transmittal letter, (2) the narrative text of this filing, which follows this transmittal letter, and (3) Attachments 1 and 2, all of which are being transmitted in a single pdf file. The Table of Contents to the narrative text lists the 2 attachments.

Please contact the undersigned if you have any questions concerning this filing.

Respectfully submitted,

/s/ Owen E. MacBride  
Owen E. MacBride

Attorney for North American Electric  
Reliability Corporation



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**ATTACHMENTS**

**Attachment 1:** Revised Working Capital and Operating Reserve Policy – Clean version.

**Attachment 2:** Revised Working Capital and Operating Reserve Policy – Redlined version

## **I. INTRODUCTION**

The North American Electric Reliability Corporation (“NERC”) requests the Commission’s approval of proposed revisions to NERC’s Working Capital and Operating Reserve (“WCOR”) Policy. Pursuant to paragraph 7(d) of the Settlement Agreement in Docket No. FA11-21-000 (“Paragraph 7(d)”), NERC is required to file for Commission review and approval certain revisions to its WCOR Policy.<sup>1</sup> The proposed revisions to the WCOR Policy fall within the scope of Paragraph 7(d); accordingly, NERC is submitting the revised WCOR Policy to the Commission for review and approval. In addition, NERC requests approval pursuant to §1107.4 of the NERC Rules of Procedure (“ROP”) for a provision of the new Assessment Stabilization Reserve component of the revised WCOR Policy

As explained herein, the principal proposed revisions to the WCOR Policy are:

- Revision to the description of Working Capital to eliminate cash balances necessary to satisfy future obligations under any covenant, financial or other obligation to which NERC is a party as a component of Working Capital; this item will now be a category of Operating Reserve, identified as the Future Obligation Reserve.
- Further classify Operating Reserve into five distinct categories, each with its own stated purpose and use (most of the categories are already reflected in the current WCOR Policy).
- Elimination, as unnecessary, of the “known contingency” component of Operating Reserve, resulting in Operating Reserve having a single Operating Contingency Reserve category, rather than both known and unforeseen contingency categories.
- Establishment of an Assessment Stabilization Reserve as a category of Operating Reserves, to be used in future periods to mitigate wide year-to-year variations in NERC’s assessments to load-serving entities (“LSEs”).
- Establishment of upper and lower guideline limits to the budgeted amount of the Operating Contingency Reserve.
- Revisions to the Guidelines and Authorities Applicable to Expenditures of Working Capital and Operating Reserves, including increasing the levels of expenditures from

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<sup>1</sup> See *North American Electric Reliability Corporation*, 142 FERC ¶61,042 (2013). Paragraph 7(d) refers to the terms “working capital reserves,” “operating reserves,” “known contingencies,” and “unforeseen contingencies” in the WCOR Policy, and states: “NERC will file proposed revisions to the Reserve Policy that would alter any of those definitions, or would change the Reserve Policy’s requirement that all excess funds be added to the unforeseen contingency operating reserves and expended in accordance with the Policy’s unforeseen contingency guidelines, for Commission review and approval.”

Operating Reserves that may be approved by, respectively, the NERC president and chief executive officer (“CEO”), the Finance and Audit Committee of the NERC Board of Trustees (“Board”), and the Board.

- Revisions to the Guidelines and Authorities Required to Reallocate Budgeted Expenditures on an Intra-Year Basis, including authorizing the president and CEO to reallocate budgeted funding to meet an unanticipated resource need, so long as funding is available from budget underruns in other areas and NERC’s overall approved budget for the year is not exceeded. Variations in expenditures compared to the budget will continue to be routinely and transparently reported.
- Elimination of the provision regarding addition of unbudgeted full-time equivalent employees (“FTE”) or headcount additions, as it is an unnecessary element of the WCOR Policy and a subject that is separately subject to oversight by the NERC Board and Board committees.

Certain provisions of the new Assessment Stabilization Reserve category of Operating Reserve in the WCOR Policy, regarding the use of penalty collections to mitigate year-to-year assessment volatility, represent a departure from the provision of §1107.2 of the NERC ROP that penalty monies received prior to July 1 of a year are to be used as a general offset to NERC’s budget for the subsequent fiscal year. Accordingly, as discussed in §III.A.2 below, NERC requests approval of this provision of the revised WCOR Policy, pursuant to §1107.4 of the ROP, as an exception to §1107.2 of the ROP.

NERC wishes to be completely clear that it is not an objective of this filing to propose or to obtain Commission approval of specific amounts of funding of Working Capital or the five categories of Operating Reserve set forth in the revised WCOR Policy, nor to propose or obtain Commission approval for specific expenditures from the reserve accounts. Specific budgeting of funds for Working Capital and the various reserves categories will be the subject of NERC’s business plan and budget process for each year, which culminates each year in approval of the proposed business plan and budget by the NERC Board and by the Commission. Similarly, specific expenditures of funds from a Working Capital or Operating Reserve category that are planned as part of the business plan and budget for a particular year will be subject to NERC Board and Commission approval as part of the business plan and budget approval process for

that year. Additionally, specific expenditures of funds from a Working Capital or Operating Reserve category that are needed during the course of a year will be implemented in accordance with the terms of the WCOR Policy applicable to each category, will be reported through the reporting mechanisms described in this filing, and will be approved in accordance with the delegations of authority set forth in the WCOR Policy, including by the Finance and Audit Committee of the NERC Board or by the Board itself, where required, in accordance with the requirements of the WCOR Policy. Further, as required by Paragraph 7(b)(ii) of the Settlement Agreement in Docket No. FA11-21-000 (“Paragraph 7(b)(ii)”), NERC will make a filing with the Commission for review and approval if any amount allocated from the Operating Contingency Reserve plus any amount redirected from previously budgeted funds is, in the aggregate, \$500,000 or more for any one specific project or major activity in a program area.

**Attachment 1** to this filing is a clean version of the revised WCOR Policy. **Attachment 2** is a redlined version of the WCOR Policy, marked to show the proposed revisions to the version of the WCOR Policy last submitted to the Commission.<sup>2</sup>

NERC respectfully requests that the Commission issue an order approving the revised WCOR Policy on or before May 21, 2015 (the scheduled date of the Commission’s public meeting for May). Approval by this date will enable NERC to incorporate the provisions of the revised WCOR Policy into the development of its 2016 Business Plan and Budget. Although the

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<sup>2</sup> The original version of the NERC WCOR Policy was provided in Exhibit C to NERC’s 2013 Business Plan and Budget filed in Docket No. RR12-13-000. An Amended WCOR Policy was provided as Attachment 1 to NERC’s November 22, 2013 compliance filing to the Commission’s order on NERC’s 2014 Business Plan and Budget filing in Docket No. RR13-9-000. *Compliance Filing of the North American Electric Reliability Corporation in Response to Paragraph 23 of November 1, 2013 Commission Order*, filed November 22, 2013 in Docket No. 13-9-001. The Commission accepted the November 22, 2013 compliance filing in a letter order issued January 3, 2014 in Docket No. RR13-9-001. In its 2015 Business Plan and Budget Filing, NERC stated that it would add a reserve for the Cybersecurity Risk Information Sharing Program (“CRISP”) to Operating Reserves in recognition of certain contingencies associated with CRISP. *See Request of the North American Electric Reliability Corporation for Acceptance of its 2015 Business Plan and Budget and the 2015 Business Plans and Budgets of Regional Entities and for Approval of Proposed Assessments to Fund Budgets*, filed August 22, 2014 in Docket No. RR14-6-000 (“2015 Business Plan and Budget Filing”), at 75 and Attachment 2 (NERC 2015 Business Plan and Budget) at 132 (Exhibit E).

2016 Business Plan and Budget is not required to be filed with the Commission for approval until August 24, 2015,<sup>3</sup> NERC will be posting drafts of its 2016 Business Plan and Budget for stakeholder review and comment beginning in late May 2015.

## **II. NOTICES AND COMMUNICATIONS**

Notices and communications concerning this filing may be addressed to:

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## **III. REVISIONS TO THE NERC WORKING CAPITAL AND OPERATING RESERVE POLICY**

There are four principal components to the proposed revisions to the WCOR Policy: (1) revisions to the components or categories of Working Capital and Operating Reserves to eliminate those that have proved to be unnecessary or not useful and to add or specify new categories appropriate to NERC’s current programs and operations;<sup>4</sup> (2) establishment of guideline upper and lower limits to the amount of Operating Contingency Reserve to be budgeted each year, based on percentages of NERC’s total budget for expenses and fixed assets (these limits to do not apply to other, specific and distinct categories of Operating Reserves established in the WCOR Policy); (3) revisions to the Guidelines and Authorities Applicable to

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<sup>3</sup> 18 C.F.R. §39.4(b).

<sup>4</sup> The WCOR Policy is also being revised to state expressly that the Working Capital and Operating Reserve requirements shall be set forth separately in NERC’s business plan and budget, which has been NERC’s practice.

Expenditures of Working Capital and Operating Reserves; and (4) revisions to the Guidelines and Authorities Required to Reallocate Budgeted Expenditures on an Intra-Year Basis.

**A. Revisions to the Components or Categories of Working Capital and Operating Reserve**

**1. Working Capital**

The description of Working Capital in the WCOR Policy is being revised to remove “cash balances reasonably necessary to meet current and future obligations under any covenant, financial, or other obligation to which the company is a party,” and make it a separate category of Operating Reserves, identified as the Future Obligation Reserve. This component is being removed from the definition of Working Capital because funds to satisfy future contractual or covenant obligations are not needed to satisfy daily cash flow requirements (which is the customary objective of the provision of Working Capital) and are more appropriately classified as a reserve. Under the revised WCOR Policy, “Working Capital” will consist only of funds needed to satisfy daily cash flow requirements throughout the year, while Operating Reserve will consist of reserves needed to support operations, including contractual and covenant obligations as well as contingencies.

The description of Working Capital is also being revised to state the factors that will be considered in determining the budgeted amount of Working Capital, as well as to acknowledge that NERC will also maintain a line of credit, which is consistent with current and past practice. With this revision and the revision described in the preceding paragraph, the description of Working Capital in the revised WCOR Policy is as follows:

**Working Capital** represents the amount of funds necessary to satisfy the company’s projected cash flow needs during the budget year, taking into account the projected timing of the receipt of funding and timing of capital and operating expenses. In addition to the foregoing, the company shall also maintain a line of credit, with a financial institution, in such amount and upon such terms and conditions, approved by the company’s Finance and Audit Committee and the NERC Board of Trustees (“Board”).



## 2. Operating Reserve

The description of Operating Reserve in the WCOR Policy is being revised to eliminate one current component of Operating Reserves and further break down Operating Reserves into five separate categories: Future Obligation Reserve, System Operator Certification Reserve, CRISP Reserve, Operating Contingency Reserve, and Assessment Stabilization Reserve. The first four of these categories are reflected in the current WCOR Policy; the last category is new.

Future Obligation Reserve represents reserves formerly included in Working Capital (as described above), and is described in the revised WCOR Policy as: “funding that has been received to satisfy future obligations under any lease, credit, loan or other agreement to which the company is a party.” The revised WCOR Policy gives examples of amounts to be held in Future Obligation Reserve: (i) office lease funding that is in excess of actual office rent expense due to a landlord’s partial abatement of rent and a budgeted lease expense based on the straight line amortization of rent expense over the term of the lease; and (ii) reserves or sinking funds requirements to meet covenant or other obligations under loan or other credit agreements. The revised Policy, like the current Policy, also specifies that these reserves shall be available to satisfy any coverage or liquidity requirements under the terms of any loan or credit agreement to which NERC is a party. Funds in the Future Obligation Reserve are to be segregated to ensure they are available for use in satisfying the future obligations.

System Operator Certification Reserve is an existing reserve that supports the System Operator Certification Program Area. The funds in this reserve are generated from the operations of the System Operator Certification Program (*i.e.*, from system operator certification and testing fees that are above incurred expenses) and are used solely to support the needs of operator testing and certification needs of that program, as determined by NERC and the Personnel Certification Governance Committee (“PCGC”).

The CRISP Reserve was established as part of NERC’s implementation of CRISP and is

used solely to support CRISP.<sup>5</sup> Amounts in the CRISP Reserve have to date been funded solely by third party industry participants in the program. The CRISP Reserve is held in a separate bank account. Addition of a CRISP component to Operating Reserve was described in the 2015 Business Plan and Budget Filing.<sup>6</sup>

The current “known contingency reserve” component of Operating Reserve is being eliminated. The current WCOR Policy provides for a known contingency reserve and an unforeseen contingency reserve. Having two contingency reserves is confusing (*i.e.*, requiring a determination as to whether a particular contingency and amount are “known” or “unforeseen”) and unnecessary. With the elimination of the known contingency reserve component, the Operating Reserve will have one general contingency reserve, captioned the Operating Contingency Reserve, consisting of “reserves for contingencies that were not anticipated, assumed to be likely or the timing of which was uncertain, at the time of preparation of the company’s business plan and budget.”<sup>7</sup> The revised WCOR Policy provides that the determination of the Operating Contingency Reserve will take into consideration projected costs and risks of ongoing operations, projected resource requirements associated with significant ongoing or emerging reliability initiatives, capital spending forecasts, and other factors that the NERC Board, Finance and Audit Committee, and management consider appropriate.

Finally, the Assessment Stabilization Reserve is a new category being added to the WCOR Policy. This category is comprised of funds that may be periodically set aside and

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<sup>5</sup> The CRISP and NERC’s participation in it were described in detail in NERC’s 2015 Business Plan and Budget Filing, at 7-8 and 61-63, and Attachment 2 (NERC 2015 Business Plan and Budget) at xviii, 55-56 and 133-141 (Exhibit F). As described in that filing, funding for the CRISP is provided primarily by third-party industry participants.

<sup>6</sup> See 2015 Business Plan and Budget Filing at 75 and Attachment 2 at 132.

<sup>7</sup> The revised WICOR Policy states examples of unforeseen contingencies: “supplemental resources required to assist in the evaluation of significant unforeseen events affecting the Bulk-Power System or to address regulatory directives not final at the time of budgeting.”

released in future periods to mitigate significant year-to-year variations in assessments.<sup>8</sup> The objective of the Assessment Stabilization Reserve is to have changes in annual assessments track, within a reasonable band, changes in NERC's total annual budget, with the total budget reflecting prudent fiscal discipline and good stewardship of resources.<sup>9</sup> The revised WCOR Policy provides that funds from this reserve category will be used when available to mitigate year-to-year swings in assessments, which can result from a variety of factors, such as application of penalty funds collected (which can and do vary widely from year to year), surplus funds available from a prior period, a need to replenish the Operating Contingency Reserve, or significant but relatively short-term operating or capital spending needs.

The revised WCOR Policy provides that the amount of the Assessment Stabilization Reserve which is budgeted in any given year will be determined based on a review of the three-year rolling forecast of assessments, as well as the availability of surplus funds and penalty funds to fund the Assessment Stabilization Reserve. The revised WCOR Policy further specifies that, except as otherwise approved by the NERC Board, funds in the Assessment Stabilization Reserve may not be used for any purpose inconsistent with the goal of this reserve category as set forth in the Policy. The proviso "except as otherwise approved by the NERC Board" provides additional flexibility for the Board to approve uses of the Assessment Stabilization Reserve in extreme and highly unusual circumstances, such as an unexpected and significant litigation expense in a particular year or a significant Bulk Power System event or events in a particular year which requires extraordinary investigation expenses. In such a case, it is

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<sup>8</sup> Background information regarding factors influencing change in assessments and historic assessment changes is included in the materials presented at the August 2014 and February 2015 meetings of the NERC Finance and Audit Committee (*see* the agenda packages for those meetings, available at: <http://www.nerc.com/gov/bot/FINANCE/Pages/2013FinanceandAuditCommittee.aspx>).

<sup>9</sup> Prudent fiscal discipline and good stewardship of resources is, of course, a primary objective of all of NERC's budgeting and expenditure decisions. However, in establishing the objectives, terms and uses of the Assessment Stabilization Reserve, NERC management believed it important to highlight that the objective of the Assessment Stabilization Reserve is to mitigate year-to-year fluctuations in assessments that result from such things as year-to-year changes in penalty payments received or the need for unusual, one-time expenditures in a particular year's budget.

anticipated that other available reserves (specifically the Operating Contingency Reserve) would have been exhausted or already drawn down to unacceptably low levels. It is also anticipated that the Board would weigh releasing funds from the Assessment Stabilization Reserve versus using other sources of funds such as drawing down NERC's line of credit. Any such proposed use of this reserve category would be identified in Finance and Audit Committee agenda and discussed in a public meeting of that Committee, and would also be identified on the Board's agenda for approval and discussed and acted upon at an open Board meeting.<sup>10</sup> The use of the Assessment Stabilization Reserve would also be identified in the quarterly budget variance reports that are posted on the NERC website and provided to the Commission.<sup>11</sup>

Additionally, any injection of funds into the Assessment Stabilization Reserve (from penalty collections or other sources), or withdrawal of funds from the Assessment Stabilization Reserve, that is included in the development of the NERC business plan and budget for a year, will be disclosed in posted drafts of the business plan and budget, subject to stakeholder review and comment, and subject to approval by the NERC Board and, ultimately, by the Commission as part of its approval of that year's business plan and budget. Each annual business plan and budget that is filed with the Commission for approval, beginning with the 2016 Business Plan and Budget, will contain a specific proposal, with justification, for the amounts (if any) to be injected into and withdrawn from the Assessment Stabilization Reserve for that year.<sup>12</sup>

NERC has experienced significant year-to-year variations in assessments. For example,

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<sup>10</sup> An exception could be if the need for funding related to a confidential matter such as funding for litigation or for an investigation of a specific Bulk Power System event or actions by a particular Registered Entity.

<sup>11</sup> As specified in Paragraph 7(b)(i) of the Settlement Agreement approved in Docket No. FA11-21-000, NERC files with the Commission, within 45 days after the end of each quarter, the unaudited report of NERC's budget-to-actual spending variances during the preceding quarter, including information regarding sources and uses of operating and working capital reserves.

<sup>12</sup> In addition to explaining, in the annual business plan and budget, any proposed injections into or withdrawals from the Assessment Stabilization Reserve in the budget year, NERC plans to include in its annual business plans and budgets two- or three-year forecasts of activity in the Assessment Stabilization Reserve and the impact on projected annual assessments for the forecast period.

for the 2011 through 2015 budgets, assessments increased on average by 8.7% per year from the previous year's budget, but the changes in assessments from year to year ranged from a low of a decrease of 6.0% to a high of an increase of 23.2%. One significant source of year-to-year volatility in NERC's assessments has been year-to-year variations in penalty monies collected by NERC, which have been used to reduce the following year's assessments. The year-to-year variability in assessment levels and the need to do something to mitigate it has been a topic of frequent stakeholder comment in recent years, including in comments submitted on posted drafts of NERC's business plans and budgets, in policy input comments provided by stakeholders to the Board, and in other interactions between stakeholders and NERC management and the Board. Stakeholders have expressed a desire for NERC to find ways to dampen the fluctuations in assessments from year to year, such as through management of penalty revenues, in order to provide greater predictability for LSEs in forecasting and budgeting for their assessment expenses.<sup>13</sup> NERC management has had numerous discussions with representatives of stakeholders and stakeholder groups and has received positive feedback on the concept of an Assessment Stability Reserve as a mechanism to reduce significant year-to-year variability in assessments. In conjunction with the Board's approval of the revised WCOR Policy at the February 2015 Board meeting, various stakeholders as well as Board members provided positive feedback and support for the Assessment Stabilization Reserve. The creation and use of an Assessment Stabilization Reserve to mitigate assessment volatility resulting from year-to-year fluctuations in penalty revenues and other causes should result in the changes in assessments, over time, more closely tracking changes in budgeted expenses and fixed asset expenditures.

Section 1107.2 of the NERC ROP states:

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<sup>13</sup> Most recently, in stakeholder policy input provided to the NERC Board for its February 2015 meeting, a number of stakeholder entities and organizations expressed support for adoption of a mechanism to mitigate volatility in year-to-year assessments, including adoption and implementation of an assessment stability reserve. *See:* [http://www.nerc.com/gov/bot/Agenda%20highlights%20and%20Mintues%202013/Policy\\_Input\\_Package\\_February\\_2015.pdf](http://www.nerc.com/gov/bot/Agenda%20highlights%20and%20Mintues%202013/Policy_Input_Package_February_2015.pdf).

All funds from financial Penalties assessed in the United States received by the entity initiating the compliance monitoring and enforcement process shall be applied as a general offset to the entity's budget requirements for the subsequent fiscal year, if received by July 1, or for the second subsequent fiscal year, if received on or after July 1.<sup>14</sup>

However, §1107.4 of the ROP states: "Exceptions or alternatives to the foregoing provisions will be allowed if approved by NERC and by FERC or any other Applicable Governmental Authority." The revised WCOR Policy will allow NERC to place penalty funds received prior to July 1 of a year into the Assessment Stabilization Reserve, to be applied in a future budget to mitigate assessment volatility, rather than using the penalty funds as a general offset to NERC's budget requirement for the subsequent fiscal year. The Assessment Stabilization Reserve will provide a source of funding in future periods to offset increases in operating and fixed asset costs that would otherwise need to be funded by increases in assessments in that year. Thus, these funds will continue to be used to reduce assessments, but in a future period rather than the next budget year. Accordingly, NERC requests that, pursuant to §1107.4 of the ROP, the Commission approve the use of penalty monies provided for in the Assessment Stabilization Reserve category of the revised WCOR Policy as an exception to §1107.2.<sup>15</sup> As stated above, proposed injections of funds into the Assessment Stabilization Reserve in a particular year's budget, as well as proposed uses of funds from the Assessment Stabilization Reserve in a particular year's budget to reduce assessments, will be fully disclosed in the Business Plan and Budget, and will be subject to stakeholder comment in the budget development process, and to review and approval by the NERC Finance and Audit Committee and Board, and, ultimately, by

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<sup>14</sup> A similar provision is set forth in the NERC policy, *Accounting, Financial Statement and Budgetary Treatment of Penalties Imposed and Received for Violations of Reliability Standards*.

<sup>15</sup> NERC considered proposing an amendment to ROP §1107 to explicitly provide for the use of penalty monies provided for in the Assessment Stabilization Reserve category of the revised WCOR Policy. NERC concluded, however, that it is preferable to first gain several years' experience with implementation of the Assessment Stabilization Reserve. NERC may propose an amendment to §1107 in the future, based on experience.

the Commission, as part of the budget approval process.<sup>16</sup>

**B. Establishment of Guideline Upper and Lower Limits to the Amount of Operating Contingency Reserve to be Budgeted Each Year**

In the revised WCOR Policy, the description of the Operating Contingency Reserve category includes the following provision:

Except as otherwise approved by the Board, after review by the Finance and Audit Committee, the amount of the Operating Contingency Reserve shall be between three and one half (3.5%) percent and seven (7%) of the company's total expense and fixed asset budget minus the sum of the System Operator Certification and CRISP budgets, each of which have separate reserves.

As an example to translate the upper and lower bounds of the stated range into dollars, based on NERC's approved 2015 budget, 3.5% to 7% equates to \$2 million to \$4 million.<sup>17</sup> In its 2014 and 2015 budgets, NERC budgeted a total of \$2 million in the unforeseen contingency and known contingency reserves, which in the revised WCOR Policy are combined into the Operating Contingency Reserve.

This provision is intended to provide guidance for management's annual recommendation to the Board as to the amount that should be budgeted for the Operating Contingency Reserve. It will place a reasonable bandwidth around the amount of the Operating Contingency Reserve that should be specified in each year's budget, subject to a decision by the NERC Board, following review by its Finance and Audit Committee, to budget more or less than the specified percentages. A recommendation by management to budget an amount less than or greater than

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<sup>16</sup> The Commission has previously approved a proposal by NERC to use penalty monies other than as specified in §1107.2 of the ROP, in order to prevent a significant increase in assessments from the prior year's budget. Specifically, in its 2015 Business Plan and Budget Filing, NERC requested and received the Commission's approval to use a significant penalty payment that was received on July 9, 2014, to reduce the NERC assessment for the 2015 budget year, rather than hold the penalty payment to use as an offset to assessments in the 2016 budget. See 2015 Business Plan and Budget Filing at 77-79. NERC showed that with application of this penalty payment to offset the 2015 assessment, the increase in the 2015 assessment over the 2014 assessment would be approximately 20% (\$1,000,000) lower than what the increase otherwise would be without this application.

<sup>17</sup> As stated in the quoted provision, the \$2 million and \$4 million figures were calculated by applying the stated percentages to NERC's 2015 total expense and fixed asset budget *less* the budgets for the System Operation Certification Program and the CRISP, each of which has its own reserve category in Operating Reserve under the revised WCOR Policy.

the stated range in the budget for a particular year will require additional justification. As noted earlier, the revised WCOR Policy specifies that the determination of the Operating Contingency Reserve amount for each year will take into consideration projected costs and risks of ongoing operations, projected resource requirements associated with significant ongoing or emerging reliability initiatives, capital spending forecasts, and other factors that the NERC Board, Finance and Audit Committee, and management consider appropriate.

In any event, the amount to be budgeted in each year for the Operating Contingency Reserve, whether within the guideline range or not, will be presented and explained in posted drafts of the business plan and budget, and will be subject to stakeholder review and comment, to review and approval by the NERC Board, and, finally, to review and approval by the Commission, as part of the annual business plan and budget review and approval process.

**C. Revisions to the Guidelines and Authorities Applicable to Expenditures of Working Capital and Operating Reserve and the Guidelines and Authorities Required to Reallocate Budgeted Expenditures on an Intra-Year Basis**

The revised WCOR Policy makes a number of revisions to the Guidelines and Authorities Applicable to Expenditures of Working Capital and Operating Reserves and the Guidelines and Authorities Required to Reallocate Budgeted Expenditures on an Intra-Year Basis. **First**, in the paragraph defining the authority of NERC's chief financial and administrative officer to draw on budgeted working capital reserves, a reference to "cash balance" requirements is deleted and a reference to "future excess cash flow" is changed to "future surplus cash flow." The deletion of the reference to "cash balance" requirements reflects that reserves needed to satisfy future obligations under leases, loan agreements and credit agreement is being moved from Working Capital to Operating Reserve under the revised Policy.

**Second**, NERC's president and CEO is authorized to approve expenditures from the System Operator Certification Reserve up to the amount set forth in the NERC budget. The System Operator Certification Reserve budget is established each year in consultation with the



PCGC, and, as stated in the WCOR Policy, expenditures from this reserve are made solely in support of the System Operator Certification Program based on guidance provided by the PCGC, which is responsible for overseeing the program.<sup>18</sup>

**Third**, the following guidelines and authorities will now apply to expenditures from the Operating Contingency Reserve and CRISP Reserve:

(i) The president and CEO can authorize expenditures up to \$500,000, and management must report the expenditures to the Finance and Audit Committee of the Board no less frequently than in the quarterly budget variance report following the expenditure from the reserves.

(ii) For expenditures greater than \$500,000 but less than \$1,000,000, prior approval of the Finance and Audit Committee is required; and

(iii) For expenditures in excess of \$1,000,000, approval of the Board is required after notice to and recommendation by the Finance and Audit Committee.

Previously, the president and CEO could authorize expenditures from the known contingencies reserve up to the amount set forth in NERC's budget and could authorize expenditures from the unforeseen contingencies reserve up to \$250,000. Expenditures greater than \$250,000 but less than \$500,000 from the known contingencies reserve required approval of the Finance and Audit Committee, and expenditures greater than \$500,000 from the known contingencies reserve required approval of the NERC Board after notice to and recommendation by the Finance and Audit Committee.

The revised WCOR Policy changes, as a matter of internal NERC governance and

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<sup>18</sup> Under the current WCOR Policy, the president and CEO is authorized to make budgeted expenditures of excess funds associated with the Personnel Certification and Operator Training Program up to the amount set forth in the budget, and to authorize unbudgeted expenditures of these funds up to \$250,000, with prior approval of the Finance and Audit Committee required for expenditures greater than \$250,000 and less than \$500,000, and Board approval required for expenditures in excess of \$500,000. However, budget and expenditure decisions for the System Operator Certification Program, including uses of reserves, are made based on the PCGC's input.

oversight by its Board in accordance with its responsibilities, the levels of expenditures from the Operating Contingency Reserve that require approval by, respectively, the NERC president and CEO, the Finance and Audit Committee, and the NERC Board. These revisions notwithstanding, however, NERC will continue to comply with the filing and approval requirement of Paragraph 7(b)(ii):

NERC will file for Commission review and approval Board-of-Trustees-approved proposals to expend \$500,000 or more from operating reserves designated for “unforeseen contingencies” (as that term is defined in NERC’s Working Capital and Operating Reserve Policy (Reserve Policy)). Each such filing will include supporting materials in sufficient detail to justify the proposed expenditure. The filing will be deemed approved if the Commission does not act on it or issue a tolling order extending the time for Commission action within thirty days of the filing date.

[T]his requirement for Commission review and approval is triggered if any amount allocated from the unforeseen contingencies account of operating reserves plus any amount redirected from previously budgeted funds is, in the aggregate, \$500,000 or more for any one specific project or major activity in a program area.

As the “known contingencies” and “unforeseen contingencies” categories of Operating Reserve are being replaced by a single Operating Contingency Reserve category, going forward NERC will treat the “unforeseen contingencies” references in Paragraph 7(b)(ii) as encompassing expenditures from the Operating Contingency Reserve.<sup>19</sup>

**Fourth**, the revised WCOR Policy eliminates the requirement that any expenditure of funds in excess of NERC’s approved budget, inclusive of Working Capital and Operating Reserves, requires prior approval of the Board after notice to and recommendation of the Finance and Audit Committee. The revised Policy now sets forth the specific dollar amounts of expenditures from Operating Reserves categories that require approval by the Board, after notice

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<sup>19</sup> In light of the specific purpose and funding sources of the CRISP Reserve and its limited uses, NERC considered not making the CRISP Reserve subject to the same guidelines and authorities as the Operating Contingency Reserve, but rather providing for expenditures from the CRISP Reserve to be subject to the determination of management and the CRISP participants (similar to the Operator Certification Reserve). However, given the nascent nature of the CRISP, NERC concluded that it would be better to obtain several years of experience with the CRISP and the CRISP Reserve before determining different guidelines and authorities are appropriate. NERC may propose different guidelines and authorities for the CRISP Reserve in the future, based on experience.

to and recommendation by the Finance and Audit Committee. As described below, the revised Policy also authorizes the president and CEO to reallocate budget underruns in one budget area to another budget area so long as the overall approved budget is not exceeded and the reallocations are reported in the quarterly variance reports.

**Fifth**, the revised WCOR Policy continues to specify that all expenditures of reserve funds are subject to applicable NERC policies and procedures, including currently effective procurement policies and delegations of authority, and shall be separately reported in the budget variance reports prepared by NERC management and included in the quarterly Finance and Audit Committee agenda materials that are posted on NERC's website.<sup>20</sup> However, this provision has been revised to specify that the applicable delegation of authority must be one that is approved by the president and CEO.

**Sixth**, the revised WCOR Policy eliminates the requirement that budgeted but unspent funds from a budget area must be transferred to the unforeseen contingency operating reserve before the president and CEO can expend such funds in other budget areas that require additional funding. The revised WCOR Policy specifies that the president and CEO can authorize the reallocation and expenditure of budgeted but unneeded funds from one budget area to another budget area, without the procedural step of first transferring the funds into the unforeseen contingency operating reserve, so long as the reallocation does not result in NERC's overall approved budget being exceeded. However, any such reallocation and expenditure of funds must be reported by management in NERC's quarterly budget variance reports which are submitted to and reviewed by the NERC Finance and Audit Committee. Further, NERC reiterates that any such expenditure and reallocation of budgeted funds will be subject to the filing and approval requirement of Paragraph 7(b)(ii) (quoted above) if the dollar amount specified in Paragraph 7(b)(ii) is reached or exceeded.

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<sup>20</sup> The Finance and Audit Committee agenda materials and meeting minutes are posted on the NERC website at: <http://www.nerc.com/gov/bot/FINANCE/Pages/2013FinanceandAuditCommittee.aspx>.

**Finally**, the revised WCOR Policy eliminates the requirement that any FTE or headcount additions which are in excess of the total FTEs or total headcount set forth in NERC's approved business plan and budget for the year must be approved by the Board after review by NERC's Corporate Governance and Human Resources Committee and Finance and Audit Committee.

It is a customary principle of corporate governance that delegations of authority to board committees and the company CEO are determined by the board based on considerations the board deems relevant. As noted above, as a matter of internal governance and board oversight and responsibility, the levels of expenditures which require authorization within the organization by different levels of management, including the president and CEO, by board committees, and by the board, should be determined by the organization's board. Here, NERC's independent Board of Trustees has concluded that the increases in the levels of expenditures from the various reserves that may be authorized by, respectively, the president and chief operating officer and the Finance and Audit Committee, rather than by the Board, are appropriate and justified, based on the following considerations:

- First, given the size of NERC's budget, the Board (as well as the Finance and Audit Committee) concluded that it was appropriate that the president and CEO have greater authority to approve the use of reserves. The \$250,000 limit on the president and CEO's authority in the current WCOR Policy represents less than 0.5% of NERC's approved 2015 budget.
- Second, over the past several years, NERC has put in place very robust and transparent financial reporting to the Finance and Audit Committee, the Board, stakeholders and the Commission.
- Third, over the past several years, NERC has implemented more robust internal control processes and procedures governing financial expenditures and vendor management.
- Fourth, under the revised WCOR Policy, the Working Capital Reserve, the Future Obligation Reserve, the System Operator Certification Reserve, the CRISP Reserve, and the Assessment Stabilization Reserve, each has a specific, limited objective and purpose or designated use of its funds, which limits and controls the expenditure of funds from the particular reserve category.

As noted throughout the foregoing description of the revised WCOR Policy, sources of funding for reserves, as well as planned uses of reserves, will be described in draft business plans

and budgets, subject to stakeholder review and comment, subject to review and approval by the NERC Finance and Audit Committee and then by the NERC Board, and finally subject to Commission approval. Expenditures of funds from reserves or reallocation of funds from one budget area to another during the year will continue to be reported in NERC's quarterly variance reports which are posted on its website, provided to the Commission, and discussed at quarterly Finance and Audit Committee meetings, and, if necessary under the Policy based on amount, will be approved by the Finance and Audit Committee or by the Board. Thus, any such uses or reallocations of funds will be publicly reported and completely transparent.<sup>21</sup>

Additionally, under the oversight and guidance of its Enterprise Risk Management Committee and Internal Controls Department, NERC has been continuously enhancing its internal controls processes, including controls and processes governing vendor procurement and management. These increased internal controls are reflected in the more detailed information on Consultant & Contracts expense that NERC has reported in its 2013, 2014 and 2015 Business Plans and Budgets submitted to the Commission.<sup>22</sup> As another example, NERC has recently updated its internal processes for vendor procurement and contract management, incorporating a requirement for a detailed, written explanation and justification for a proposed contract, including a description of the procurement method used, information on the proposed counterparty, descriptions of the proposed services, scope of work, costs and budget, and whether the expenditure is provided for in the current year budget. It also requires approvals by various levels of management, depending on the nature of the contract and the amount, as well as designation of management personnel responsible for vendor management and oversight.<sup>23</sup>

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<sup>21</sup> NERC also prepares monthly variance and reserve usage reports for internal use by management.

<sup>22</sup> *See, e.g.*, Attachment 2 (NERC Business Plan and Budget) to the 2015 Business Plan and Budget Filing, at 126-127 (Exhibit C).

<sup>23</sup> Additional information on enhanced controls over expenditures and enhanced financial reporting that NERC has put in place over the past two years, and has now had experience in implementing, was provided in NERC's 2015 Business Plan and Budget (*see* Attachment 2 to the 2015 Business Plan and Budget Filing at xvi-xvii) and in NERC's 2014 Business Plan and Budget Filing (*see Request of the North*

With the more detailed descriptions of the Working Capital and Operating Reserve categories and their purposes and limitations in the revised WCOR Policy, along with the combination of highly transparent budgeting, variance reporting and approval processes and increasingly stronger internal controls, the increases in authorization levels for expenditures from the various reserves categories are both warranted and appropriate.

The deletion of the provision requiring that funds budgeted for but not needed in a budget area must be transferred to the unforeseen contingency operating reserve before they can be expended in another budget area where greater resources are needed, provides for greater administrative efficiencies and eliminates an unnecessary procedural step. Further, the business plan and budget development and approval process necessitates that the business plan and budget for a year must be essentially finalized six months before the start of that year and 18 months before the end of that year. With so much lead time from budget finalization to actual manifestation of resource and expenditure needs, it is extremely difficult to anticipate how actual resource needs may vary from what was projected in developing the budget for each program area. The ability for management to reallocate budgeted funds from budget areas for which fewer resources are needed than anticipated, to budget areas for which greater resources are needed than anticipated (so long as the total NERC budget is not exceeded), provides flexibility needed for management to effectively manage NERC's resources during the year to accomplish the objectives of all of its programs. However, as provided in the revised WCOR Policy, all such reallocations must be reported by management in the quarterly variance reports, thereby providing stakeholders and the Commission with complete visibility of any such reallocations. Further, all such reallocations will be subject to the filing and approval requirement of Paragraph 7(b)(ii) if the amount specified in Paragraph 7(b)(ii) is reached or exceeded.

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*American Electric Reliability Corporation for Acceptance of its 2014 Business Plan and Budget and the 2014 Business Plans and Budgets of Regional Entities and for Approval of Proposed Assessments to Fund Budgets*, filed August 23, 2013, in Docket No. RR13-9-000, at 9-10 and Attachment 2 (NERC 2014 Business Plan and Budget) at 16-17).

Finally, the deletion from the WCOR Policy of the provision pertaining to increases in FTEs and headcount is appropriate because increases in FTEs and headcount are not directly related to the management of Operating Reserve and are not appropriately included in a Working Capital and Operating Reserve Policy. Further, FTE and headcount numbers are otherwise subject to ongoing oversight by the NERC Corporate Governance and Human Resources Committee, the Finance and Audit Committee, and the Board. Additionally, the quarterly variance reports to the Finance and Audit Committee and the Board, which are publicly posted, available to stakeholders, and provided to the Commission, include information on actual versus budgeted FTEs. If an increase in FTEs or headcount during a year above the budgeted levels requires either the expenditure of funds from an applicable reserve category or the reallocation of funds from one budget area to another, then the WCOR Policy provides for the appropriate review, approval and reporting of the expenditures.

**D. NERC Board Approval of the Revised WCOR Policy**

The NERC Board of Trustees approved the revised WCOR Policy at its February 12, 2015 meeting.

**E. Request for Prompt Action on this Filing**

NERC respectfully requests that the Commission consider and act on this request, by issuing an order approving the revised WCOR Policy on or before May 21, 2015 (which is the scheduled date for the Commission's monthly public meeting for May). Approval of the revised WCOR Policy by May 21 will enable NERC to incorporate the revised WCOR Policy into its business planning and budgeting process for the 2016 Business Plan and Budget, including proposing specific amounts to be injected into and withdrawn from the Working Capital and the various categories of Operating Reserves in the 2016 Business Plan and Budget. Although NERC's 2016 Business Plan and Budget is not required to be filed with the Commission for approval until August 24, 2015, NERC will be posting drafts of its 2016 Business Plan and

Budget for stakeholder review and comment beginning in late May. Inclusion and explanation of specific proposed Working Capital and Operating Reserve injection and withdrawal amounts, based on the revised WICOR Policy, in the posted drafts of the 2016 Business Plan and Budget will maximize the opportunities for stakeholders to understand and comment on these proposals.

#### **IV. CONCLUSION**

The North American Electric Reliability Corporation respectfully requests that the Commission approve NERC's revised Working Capital and Operating Reserve Policy, **Attachment 1** to this filing, including approving, pursuant to §1107.4 of the NERC Rules of Procedure, the use of penalty monies as provided for in the Assessment Stabilization Reserve category of Operating Reserve in the WCOR Policy, as an exception to §1107.2 of the ROP. NERC respectfully requests an order approving its request on or before May 21, 2015.

Respectfully submitted,

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**ATTACHMENT 1**

**REVISED WORKING CAPITAL AND OPERATING RESERVE POLICY**

**CLEAN VERSION**

## Working Capital and Operating Reserve Policy

This policy governs the determination of the company's annual working capital and operating reserve requirements, as well as the authorization of management to access these funds.

The company's working capital and operating reserve requirements shall be set forth separately in the company's business plan and budget.

**Working Capital** represents the amount of funds necessary to satisfy the company's projected cash flow needs during the budget year, taking into account the projected timing of the receipt of funding and timing of capital and operating expenses. In addition to the foregoing, the company shall also maintain a line of credit, with a financial institution, in such amount and upon such terms and conditions, approved by the company's Finance and Audit Committee and the NERC Board of Trustees ("Board").

**Operating Reserves** represent reserves necessary to support operations, including contingencies. Operating Reserves shall be divided into four categories: (1) reserves that are being held in order to satisfy future obligations under any lease, credit, loan agreement or other obligation to which the company is a party (the "**Future Obligation Reserve**"); (2) reserves to support the System Operator Certification Program Area Reserve (the "**System Operator Certification Reserve**"); (3) reserves to support the Cybersecurity Risk Information Sharing Program, known as CRISP (the "**CRISP Reserve**"); (4) reserves to fund reasonable and appropriate expenditures that were not assumed likely or anticipated in the company's budget or for which the timing was uncertain (the "**Operating Contingency Reserve**"). In addition to the foregoing reserves, funds may periodically be set aside in a separate reserve and released in future periods in order to mitigate wide year-to-year variations in assessments (the "**Assessment Stabilization Reserve**").

The amount of the company's **Working Capital, Future Obligation Reserve, System Operator Certification Reserve, CRISP Reserve, Operating Contingency Reserve** and **Assessment Stabilization Reserve** shall be identified separately and quantified each year in the business plan and budget submitted to and reviewed by the Finance and Audit Committee, and approved by the Board.

The following additional guidelines shall apply to the determination of the company's Operating Reserves and Assessment Stabilization Reserve:

### **Future Obligation Reserve**

The Future Obligation Reserve includes funding that has been received to satisfy future obligations under lease, credit, loan or other agreement to which the company is a party. An example is office lease funding that is in excess of actual office rent expense due to a landlord's partial abatement of rent and a budgeted lease expense based on the straight line amortization of rent expense over the term of the lease. In such a case, this surplus funding is being held to offset future rent

expense. Another possible example includes reserves or sinking funds requirements to meet covenant or other obligations under loan or other credit agreements.

#### **System Operator Certification Reserve**

The System Operator Certification Reserve supports the system operator certification program, and includes surplus funding from operator certification and testing fees that are above incurred expenses. Consistent with the intent of Section 604.4.10 of the Rules of Procedures, this reserve shall be used solely to support operator testing and certification needs, as determined by the company and the Personnel Certification Governance Committee.

#### **CRISP Reserve**

The CRISP Reserve is maintained to support CRISP. The CRISP Reserve shall be held in a separate bank account and used solely for CRISP funding.

#### **Operating Contingency Reserve**

The Operating Contingency Reserve are reserves for contingencies that were not anticipated, assumed to be likely or the timing of which was uncertain, at the time of preparation and approval of the company's business plan and budget. The determination of the amount of the Operating Contingency Reserve shall take into consideration the projected costs and risks of ongoing operations, projected resource requirements associated with significant ongoing or emerging reliability initiatives, capital-spending forecasts and other factors that the Board, Finance and Audit Committee, and management consider appropriate. Examples of unforeseen contingencies might include supplemental resources required to assist in the evaluation of significant unforeseen events affecting the Bulk-Power System or to address regulatory directives not final at the time of budgeting. Except as otherwise approved by the Board, after review by the Finance and Audit Committee, the amount of the Operating Contingency Reserve shall be between three and one half (3.5%) percent and seven (7%) percent of the company's total expense and fixed asset budget minus the sum of the System Operator Certification and CRISP budgets, each of which have separate reserves.

#### **Assessment Stabilization Reserve**

The goal of the Assessment Stabilization Reserve is to mitigate assessment volatility and have changes in annual assessments track, within a reasonable band, changes in the company's total annual budget, with the total budget reflecting prudent fiscal discipline and good stewardship of resources. Assessment stabilization funds will be used when available to help stabilize assessments and mitigate year-to-year swings in assessments, which can result from a variety of factors, including but not limited to the application of penalty funds, surplus funds available from a prior period, a need to replenish the Operating Contingency Reserve, or significant but relatively short term operating or capital spending needs. The amount of the Assessment Stabilization Reserve which is budgeted in any given year shall be determined based on a review of a three-year rolling forecast of assessments, as well as the availability of surplus funds and penalty funds to fund this reserve. Except as otherwise approved by the Board, funds in the Assessment Stabilization Reserve may not be used for any purpose inconsistent with the goal of the reserve set forth in this paragraph.

**Guidelines and Authorities Applicable to Expenditures of Working Capital and Operating Reserves**

The following guidelines, limitations and authorities shall apply to expenditures of working capital and operating reserves.

1. The chief financial and administrative officer shall have the authority to draw on budgeted working capital reserves to the extent necessary to satisfy daily cash flow requirements. To the extent necessary to meet projected cash flow and cash balance requirements, any such draws of working capital reserves shall, to the extent possible, be promptly replenished from future surplus cash flow.
2. The company's president and chief executive officer is authorized to approve expenditures of System Operator Certification Reserves up to the amount set forth in the company's budget.
3. For Operating Contingency Reserve and CRISP Reserve expenditures:
  - i. The president and chief executive officer is authorized to make expenditures up to \$500,000 and management shall report such expenditures to the Finance and Audit Committee no less frequently than in the quarterly company budget variance report following the expenditure of such reserves;
  - ii. For expenditures greater than \$500,000 but less than \$1,000,000, prior approval of the Finance and Audit Committee is required; and
  - iii. For expenditures in excess of \$1,000,000, approval of the Board is required, after notice to and recommendation by the Finance and Audit Committee.
4. The company shall segregate Future Obligation Reserves to ensure they are available for use in satisfying such future obligations; provided however, such funds shall also be available to satisfy any coverage and liquidity requirements under the terms of any loan or credit agreement to which the company is a party.

All expenditures of reserve funds are subject to other applicable company policies and procedures, including currently effective procurement policies and delegations of authority approved by the president and chief executive officer, and shall be separately reported in the budget variance reports prepared by management, and included in the quarterly Finance and Audit Committee agenda materials that are posted on the company's website.

The procedures set forth in Section 1108 of the Rules of Procedure, including Board and FERC approval, shall continue to apply in circumstances where the company requires funding between normal annual budget cycles in excess of amounts available through approved assessments, working capital and operating reserve resources.

**Guidelines and Authorities Required to Reallocate Budgeted Expenditures on an Intra-year Basis**

During the course of the year, events may unfold such that some approved budget areas may run below budget, making funds available to satisfy other resource needs based on changing priorities. In the event such under runs occur, the president and chief executive officer shall have the authority to reallocate and expend such funds, provided that such reallocation and expenditure does not result in the company's overall approved budget being exceeded and such expenditures shall be reported by management in the company's quarterly budget variance reports, which are submitted to and reviewed by the Finance and Audit Committee.

**ATTACHMENT 2**

**REVISED WORKING CAPITAL AND OPERATING RESERVE POLICY**

**REDLINED VERSION**

## Working Capital and Operating Reserve Policy

This policy governs the determination of the company's annual working capital and operating reserve requirements ~~which are included in the company's annual business plan and budget and, as well as~~ the authorization of management to access these funds.

The company's working capital ~~requirement and operating reserve requirements~~ shall be set forth separately in the company's business plan and budget.

**Working Capital** represents the amount of funds necessary to satisfy the company's projected cash flow and cash balance requirements. Cash flow and cash balance requirements shall be determined based on a review of needs during the budget year, taking into account the projected (a) cash flow needs timing of the receipt of funding and (b) cash balances reasonably timing of capital and operating expenses. In addition to the foregoing, the company shall also maintain a line of credit, with a financial institution, in such amount and upon such terms and conditions, approved by the company's Finance and Audit Committee and the NERC Board of Trustees ("Board").

**Operating Reserves** represent reserves necessary to ~~meet current and support operations, including contingencies. Operating Reserves shall be divided into four categories: (1) reserves that are being held in order to satisfy future obligations under any covenant, financial lease, credit, loan agreement or other obligation under the terms of any loan, credit, or lease agreement to which the company is a party. To the extent that during the year the working capital cash balances maintained to satisfy any covenant, financial or other obligations under the terms of any loan, credit or lease agreement are reduced, such excess cash balance will be transferred to the company's operating reserve for unforeseen contingencies and subject (the "Future Obligation Reserve"); (2) reserves to the guidelines and authorities applicable support the System Operator Certification Program Area Reserve (the "System Operator Certification Reserve"); (3) reserves to support the Cybersecurity Risk Information Sharing Program, known as CRISP (the "CRISP Reserve"); (4) reserves to fund reasonable and appropriate expenditures thereof set forth below that were not assumed likely or anticipated in the company's budget or for which the timing was uncertain (the "Operating Contingency Reserve"). In addition to the foregoing reserves, funds may periodically be set aside in a separate reserve and released in future periods in order to mitigate wide year-to-year variations in assessments (the "Assessment Stabilization Reserve").~~

~~The company's operating reserves shall include (1) an amount necessary to satisfy known contingencies where the specific timing and amount is uncertain, (2) an amount available to be utilized for unforeseen contingency and (3) excess funds applicable to the Personnel Certification and Operator Training Program.~~

The amount of the company's working capital and operating reserves, by category, of the company's **Working Capital, Future Obligation Reserve, System Operator Certification Reserve, CRISP Reserve, Operating Contingency Reserve** and **Assessment Stabilization Reserve** shall be separately identified

~~separately and quantified each year in the business plan and budget submitted to and approved by the Board of Trustees. Transfers of working capital to operating reserves and transfers of operating reserve funds between categories shall require approval of the Board of Trustees, after review and recommendation by the Finance and Audit Committee.~~  
reviewed by the Finance and Audit Committee, and approved by the Board.

The following additional guidelines shall apply to the determination of the company's ~~operating reserves.~~

~~(1) Known Contingencies Where the Amount Operating Reserves and Timing Are Uncertain Assessment Stabilization Reserve:~~

~~This category of operating reserves represents estimated funding reserves known contingencies where the timing and amount of funding to satisfy the contingency when it materializes is uncertain. An example would be the need for additional resources to address a requirement or process where regulatory or other governmental authorizations or directives are pending or anticipated but an order has not yet been issued so the amount of the impact and timing is uncertain, but management has nevertheless concluded that additional resources are likely to be required.~~

~~(2) Unforeseen Contingencies~~

~~This category of operating reserves represents a funding reserve for unknown contingencies which~~  
**Future Obligation Reserve**

~~The Future Obligation Reserve includes funding that has been received to satisfy future obligations under lease, credit, loan or other agreement to which the company is a party. An example is office lease funding that is in excess of actual office rent expense due to a landlord's partial abatement of rent and a budgeted lease expense based on the straight line amortization of rent expense over the term of the lease. In such a case, this surplus funding is being held to offset future rent expense. Another possible example includes reserves or sinking funds requirements to meet covenant or other obligations under loan or other credit agreements.~~

**System Operator Certification Reserve**

~~The System Operator Certification Reserve supports the system operator certification program, and includes surplus funding from operator certification and testing fees that are above incurred expenses. Consistent with the intent of Section 604.4.10 of the Rules of Procedures, this reserve shall be used solely to support operator testing and certification needs, as determined by the company and the Personnel Certification Governance Committee.~~

**CRISP Reserve**

~~The CRISP Reserve is maintained to support CRISP. The CRISP Reserve shall be held in a separate bank account and used solely for CRISP funding.~~

**Operating Contingency Reserve**

~~The Operating Contingency Reserve are reserves for contingencies that were not anticipated, assumed to be likely or the timing of which was uncertain, at the time of preparation and approval of the ~~business plan and budget.~~ company's business plan and budget. The determination of the amount of the Operating Contingency Reserve shall take into consideration the projected costs and risks of ongoing operations, projected resource requirements associated with significant~~



ongoing or emerging reliability initiatives, capital-spending forecasts and other factors that the Board, Finance and Audit Committee, and management consider appropriate. Examples of unforeseen contingencies might include supplemental resources required to assist in the evaluation of significant unforeseen events affecting the ~~bulk power system, such as the February Cold Weather Event and Southwest Outage or to address unforeseen regulatory directives.~~ Bulk-Power System or to address regulatory directives not final at the time of budgeting. Except as otherwise approved by the Board, after review by the Finance and Audit Committee, the amount of the Operating Contingency Reserve shall be between three and one half (3.5%) percent and seven (7%) percent of the company's total expense and fixed asset budget minus the sum of the System Operator Certification and CRISP budgets, each of which have separate reserves.

~~(3) Excess Funds applicable to the Personnel Certification and Operator Training Program~~

~~In the event the company realizes higher levels of funding from operator certification and training above incurred expenses, this excess funding shall constitute a separate category of operating reserve and shall be used solely for operator training and certification needs, as determined by the company and the Personnel Certification Governance Committee. This is consistent with the intent of Section 604.4.10 of the Rules of Procedures.~~

**Assessment Stabilization Reserve**

The goal of the Assessment Stabilization Reserve is to mitigate assessment volatility and have changes in annual assessments track, within a reasonable band, changes in the company's total annual budget, with the total budget reflecting prudent fiscal discipline and good stewardship of resources. Assessment stabilization funds will be used when available to help stabilize assessments and mitigate year-to-year swings in assessments, which can result from a variety of factors, including but not limited to the application of penalty funds, surplus funds available from a prior period, a need to replenish the Operating Contingency Reserve, or significant but relatively short term operating or capital spending needs. The amount of the Assessment Stabilization Reserve which is budgeted in any given year shall be determined based on a review of a three-year rolling forecast of assessments, as well as the availability of surplus funds and penalty funds to fund this reserve. Except as otherwise approved by the Board, funds in the Assessment Stabilization Reserve may not be used for any purpose inconsistent with the goal of the reserve set forth in this paragraph.

**Guidelines and Authorities Applicable to Expenditures of Working Capital and Operating Reserves**

The following guidelines, limitations and authorities shall apply to expenditures of working capital and operating reserves.

1. The ~~Chief Financial~~chief financial and ~~Administrative Officer~~administrative officer shall have the authority to draw on budgeted working capital reserves to the extent necessary to satisfy daily cash flow ~~and cash balance~~ requirements. To the extent necessary to meet projected cash flow and cash balance requirements, any such draws of working capital reserves shall, to the extent possible, be promptly replenished from future ~~excess~~surplus cash flow.

2. ~~For expenditures of operating reserves for budgeted known contingencies, the~~The company's president and chief executive officer is authorized to ~~expend such reserves~~approve expenditures of System Operator Certification Reserves up to the amount set forth in the company's budget.
3. ~~For budgeted~~For Operating Contingency Reserve and CRISP Reserve expenditures ~~of excess funds associated with the Personnel Certification and Operator Training Program, the company's:~~
- 3.i. ~~The~~ president and chief executive officer is authorized to ~~expend such reserves up to the amount set forth~~make expenditures up to \$500,000 and management shall report such expenditures to the Finance and Audit Committee no less frequently than in the ~~company's quarterly company~~ budget. variance report following the expenditure of such reserves;
4. ~~For expenditures of operating reserves budgeted for unforeseen contingencies, including the expenditure of excess working capital reserves which are transferred to the company's operating reserve for unforeseen contingencies, and for unbudgeted expenditures of excess funds associated with the Personnel Certification and Operator Training Program:~~
- i. ~~The president and chief executive officer shall have authority to make expenditures up to \$250,000;~~
- ii. For expenditures greater than ~~\$250~~500,000 but less than ~~\$500~~1,000,000, prior approval of the Finance and Audit Committee is required; and
- iii. For expenditures in excess of ~~\$500~~1,000,000, approval of the Board ~~of Trustees~~ is required, after notice to and recommendation by the Finance and Audit Committee.
- 5.4. ~~To the extent that working capital reserves include reserves to satisfy future financial, covenant or other obligations, the~~The company shall segregate ~~such funds~~Future Obligation Reserves to ensure they are available for use in satisfying such future ~~financial, covenant or other~~ obligations; provided however ~~that~~, such funds shall also be available to satisfy any coverage and liquidity requirements under the terms of any loan or credit agreement to which the company is a party.
6. ~~Any expenditure of funds in excess of the company's approved budget, inclusive of budgeted working capital and operating reserves, requires the prior approval of the Board of Trustees, after notice to and recommendation of the Finance and Audit Committee.~~

All expenditures of contingency reserve funds are subject to other applicable company policies and procedures, including currently effective procurement policies and delegations of authority approved by the president and chief executive officer, and shall be separately reported in the budget variance reports prepared by management, and included in the quarterly Finance and Audit Committee agenda materials, ~~which that~~ are posted on the company's website.

The procedures set forth in Section 1108 of the Rules of Procedure, including Board ~~of Trustees~~ and FERC approval, shall continue to apply in circumstances where the company requires funding between normal

annual budget cycles in excess of amounts available through approved assessments, working capital and operating reserve resources.

#### **Guidelines and Authorities Required to Reallocate Budgeted Expenditures on an Intra-year Basis**

During the course of the year, events may unfold such that some approved budget areas may run below budget, making funds available to satisfy other resource needs based on changing priorities. In the event such under runs occur, ~~these excess funds shall be added to the unforeseen contingency operating reserve and~~ the president and chief executive officer shall have the authority to reallocate and expend such funds, provided that such reallocation and management shall also be responsible for reporting expenditure does not result in the company's overall approved budget being exceeded and such expenditures, in the same manner as shall be reported by management in the company's quarterly budget variance reports, which are submitted to and reviewed by the ~~expenditure of funds for other unforeseen contingencies set forth above~~ Finance and Audit Committee.

#### **~~Addition of Unbudgeted FTE or Headcount Additions~~**

~~Any FTE or headcount additions, regardless of the source of and availability of funding, which are in excess of the total FTEs or total headcount, respectively, set forth in the company's approved business plan and budget for the applicable budget year shall require approval of the Board of Trustees, after review by the Corporate Governance and Human Resources Committee and the Finance and Audit Committee.~~