

## MEMORANDUM

**TO:** Fred W. Gorbet, Chair  
NERC Board of Trustees

**FROM:** Carol Chinn  
Vicken Kasarjian  
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**DATE:** January 31, 2017

**SUBJECT:** Response to Request for Policy Input to NERC Board of Trustees

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The Sector 2 and 5 members of the NERC Member Representatives Committee (“MRC”), representing State/Municipal and Transmission Dependent Utilities (“SM-TDUs”), appreciate the opportunity to respond to your letter dated January 10, 2017 to Mr. Nabil Hitti, Chair of the MRC, requesting policy input on topics that will be of particular interest during the upcoming meetings of the NERC Board of Trustees, Board committees, and the NERC MRC on February 8-9, 2017.

### *Summary of Comments*

#### ➤ **Item 1: ERO Enterprise Strategic Planning Process**

- The RISC and future iterations of the RISC Report, more broadly supplemented by stakeholder comments and bounded by the ERO’s statutory authority, should define the scope of longer-term planning.
- A significant shift in the strategic plan direction has occurred this cycle without sufficient MRC dialogue. A key aspect that should be discussed is the definition of “reliability risk,” which goes beyond the established notion of “adequate level of reliability.” The MRC, BOT and ERO staff should have an interactive dialogue on this policy change.
- Updates to the RISC Report and the Operational Plan could occur every two years, but more detailed information is required for the newly established metrics before we are ready for that longer-term approach.
- The ERO should monitor longer-term issues, but should not expend resources to address issues that are not anticipated to arise within the next five years. Instead, the ERO’s Operational Plan should focus on immediately emerging risks along with ERO performance of its core functions.

#### ➤ **Item 2: Next Steps for Distributed Energy Resources Task Force (DERTF) Final Report**

- The response to the DERTF recommendations should be consistent with and not exceed the ERO’s statutory authority.

- The ERO should rely on the Operational Plan to set the prioritization and timing of responses to the DERTF recommendations, and the DERTF should map its recommendations to the elements of the Operational Plan.
- The DERTF or some form of this task force should remain in existence to assist in the ERO's response to its recommendations and to address MRC and BOT questions about policy issues and technical concerns.

➤ **Additional Area of Concern:**

- The BOT should not allow the “ERO Enterprise for Internal Controls” (posted December 22, 2016) to go into effect. This new guide expands the ERO's reliance on the evaluation of a registered entity's internal controls from a voluntary step to a mandatory requirement that will be assessed based on unwritten standards. Such changes should only occur as a result of deliberative amendment to the Reliability Standards and Rules of Procedure and not simply from the unilateral posting of a new guide.
- This new expectation for registered entities to provide internal controls during compliance monitoring is an unnecessary and significant increased burden on registered entities. Registered entities are still faced with a “zero tolerance” expectation to comply with NERC standards with documented evidence, and now they have the added expectation of documenting internal controls for a regulator to review.

***Item 1: ERO Enterprise Strategic Planning Process***

*The Board requests MRC policy input on the following:*

*1. What should the scope of the proposed longer-term strategy include?*

As reflected in the SM-TDUs' Response to Request for Policy Input to the NERC Board of Trustees dated October 18, 2016, the SM-TDUs endorse the analytical framework and issues identified by the Reliability Issues Steering Committee (“RISC”), and we would generally support the reliance of the ERO on the RISC and future RISC Reports to drive the scope of any longer-term strategic plan or metrics.

With that said, however, we would ask the ERO to be mindful of two caveats to that general approach. First, we continue to urge the BOT to ensure that each element of the ERO Enterprise Strategic Plan and Metrics (“Operational Plan”) keeps its focus on the Bulk Electric System to ensure an Adequate Level of Reliability and to reflect due consideration of costs. As the ERO transitions to longer-term planning, there may be a natural tendency to expand the scope beyond the ERO's statutory authority, which in turn would drive the ERO's costs and budget above what would be considered just and reasonable. The ERO's statutory jurisdiction should provide a natural boundary for the scope of both future RISC Reports and future Operational Plans.

Second, because we believe the identification of risks and the establishment of strategy within the ERO enterprise should be shared and collaborative, there should be ample opportunities for interactive dialogue among representatives of the NERC Board, MRC, and NERC staff on the RISC Report and the Operational Plan before the final versions of these documents are adopted. To date, input from the BOT and MRC has not been adequately considered, and therefore, we recommend a more formal interactive process be established.

2. *Do you agree with updating the RISC Report, ERO Enterprise Operational Plan, and metrics every two years versus annually?*

The SM-TDUs would support the move to update the RISC Report and Operational Plan every two years instead of annually, but we believe that several changes need to be made before to the metrics both in their current form and as they are applied in the future.

First, as reflected in the October 18, 2016 SM-TDU Policy Input, the process for establishing metrics needs to be more transparent and must focus more on risk mitigation over time than merely tracking routine reliability metrics that have low probabilistic impact on the BES.

Second, to gain a better understanding of the metrics once they are appropriately established, we would suggest that the ERO be more transparent on performance tracking against the metrics. In fact, it would be helpful for ERO staff to post enough detailed data so regions and registered entities can assess and analyze performance.

Third, it is not clear what impact the ERO staff should have on the metrics and goals chosen. Considering the ERO was established to develop and enforce reliability standards, it is not clear that achieving the metrics chosen will reflect how well the ERO is performing relative to its core responsibilities.

Finally, with respect to NERC's proposal to make interim updates if any significant new emerging risks or operational goals arise, the ERO enterprise should work together with industry to define "significant" using specific criteria. It is not clear what the past performance has been of the chosen metrics and the impact on the BES. This will help to ensure that (1) there is a proper elevation and evaluation of issues and (2) we do not fall into the trap of treating every new issue as "significant" or missing a truly significant issue due to lack of focus.

3. *Are there improvements the RISC should consider in the development of the RISC report?*

As noted above and in our October 18, 2016 SM-TDU Policy Input, the SM-TDUs support the analytical framework and issues identified by the RISC, and while we had issues about the relative priorities assigned by RISC, we did not identify any significant risks that were overlooked. Our concerns remain with how the RISC priorities link to the ERO goals and metrics.

4. *Are there specific improvements the ERO Enterprise should consider in the development of updates to the ERO Enterprise Operational Plan?*

The SM-TDUs recommend that NERC adopt a radar approach to monitor longer-term issues that are five or more years on the horizon. However, NERC should not propose specific actions to address these longer-term issues unless there is further detailed consideration and consultation with industry. To properly allocate resources, NERC should focus its planning, prioritization, and actions on more immediate issues, i.e., issues expected to emerge within (and not beyond) the next 5 years. This is consistent with strategic planning time frames in the industry.

With respect to the Measures for Success identified in Appendix 1: Metrics, the SM-TDUs previously commented that the Measures for Success in the draft presented last November generally provide indicators that a reliability outcome has been achieved, but that the Measures for Success do not measure success in risk mitigation. The SM-TDUs also noted that the performance measures identified in Metric 6 reflect previously identified and largely mitigated risk areas, and we suggested that Metric 6 be revised to focus more on emerging risks. Notwithstanding these comments, the Operational Plan posted on December 21, 2016 fails to address these concerns and is largely unchanged from the version presented to the BOT and the MRC in November.

*5. Does the 2017 schedule provide adequate opportunity for stakeholder input into the strategic planning process?*

No. The MRC input is not early enough in the process and strategic decisions for ERO direction are not vetted and discussed. A significant shift in the strategic plan direction occurred this cycle without sufficient MRC dialogue. A key aspect that should be discussed is how “reliability risk” is defined. “Adequate level of reliability” has been the recognized guidance, but the 2017 goals and metrics go beyond that established definition. SM-TDUs suggest that an interactive dialogue on this policy change occurs with representation of MRC, BOT, and ERO staff.

***Item 2: Next Steps for Distributed Energy Resources Task Force (DERTF) Final Report***

*The Board requests MRC policy input regarding how and at what pace NERC should respond to the recommendations, based on the findings identified in the DERTF report.*

The SM-TDUs have supported the DERTF and its work plan for developing its report. Now that the report is completed, we have a number of recommendations with respect to how and at what pace NERC should respond to the recommendations.

First, as we noted above in response to question 1 of Item 1 with respect to the RISC Report and as we commented in the August 3, 2016 SM-TDU Policy Input to the NERC BOT, the SM-TDUs would again caution NERC not to exceed the limits of its authority under section 215 of the Federal Power Act. NERC’s response to the DERTF Report must focus on the operational and reliability impact of distributed energy resources on the BPS.

Second, with respect to the 7 recommendations in Chapter 7 of the Report, we believe that NERC should develop a roadmap or work plan on how it will address each of the issues and could establish prioritization in two different ways. First, the ERO enterprise could determine

which recommendations are the priorities irrespective of time and effort needed to accomplish the priorities. Although the SM-TDUs continue to comment on the Operational Plan as discussed above in Item 1, the SM-TDUs generally support it as a framework for prioritizing the mitigation of reliability risks and other ERO activities. Accordingly, one response to the DERTF's recommendations should be to incorporate them into the prioritization outlined in the Strategic Plan. Because the Strategic Plan identifies "Changing Resource Mix" (Risk Profile #1), "BPS Planning" (Risk Profile #2) and "Resource Adequacy and Performance" (Risk Profile #3) as high priorities, the ERO should be able to address many of the recommendations of the DERTF in accordance with time frames set for mitigation in these Risk Profiles without the need for either fundamentally revising the Operational Plan or waiting two years for the next strategic planning cycle. The BOT should, therefore, ask that the DERTF map its recommendations to elements of the Strategic Plan and then direct the ERO to address the DERTF recommendations in the context of and according to the timelines specified in the Operational Plan.

An alternative and/or parallel approach to prioritization would be for the ERO enterprise to set priorities by identifying the "lowest hanging fruit," or the easiest items to accomplish, but NERC should take this approach with appropriate deliberation and stakeholder input. Within specific recommendations, there are aspects that will be easier or harder to accomplish. For example, within the first DERTF recommendation, updating Reliability Standard MOD-032 to add Distribution Provider as an applicable entity should be relatively easy, but general guideline development would be a longer-term effort, as would more substantive changes to reliability standards.

Clearly more work needs to be done, and we ask that the BOT not disband the DERTF, but allow it, or some form of the task force, to remain in place to address policy issues and technical concerns that the MRC and the BOT may identify. The DERTF members have devoted substantial work to prepare the report, and it would serve the industry well to keep this accumulated expertise in place as the ERO begins to implement its recommendations.

***Additional Area of Concern:***

*Internal Controls*

Finally, the SM-TDUs also would like to express concerns about the "ERO Enterprise Guide for Internal Controls" ("Internal Controls Guide") recently posted on December 22, 2016. We understand that this document replaces the "ERO Enterprise Internal Control Evaluation Guide" ("ICE Guide"). We have concerns about both how the Internal Controls Guide was developed and how qualitative judgments about internal controls will be made and used by the ERO in the future.

With respect to the former, we are concerned that the development of the new Internal Controls Guide was not developed in a transparent manner and did not allow for comprehensive stakeholder input. Although we understand that the Internal Controls Guide collects comments and thoughts raised at various Regional Entity workshops, there was no opportunity to review and comment on the Internal Controls Guide before its posting.

With respect to the latter, we are concerned that the Internal Controls Guide not only shifts, but also greatly expands, the ERO's assessment of a registered entity's internal controls (again without any transparent process of stakeholder input). As originally formulated in the Reliability Assurance Initiative under the ICE Guide, the evaluation of internal controls was a **voluntary** step in developing an entity's Compliance Oversight Plan. By contrast, under the Internal Controls Guide, the ERO has formalized the review of internal controls during actual compliance monitoring (even where a registered entity has chosen not to participate in an Internal Control Evaluation) and intends to use that review in the formulation of audit findings and in enforcement activities. As such, the review of internal controls is no longer a voluntary activity chosen by the registered entity, but rather the ERO is imposing a **mandatory** requirement for internal controls based on unwritten standards.

We ask that the BOT take a hard look at the Internal Controls Guide, specifically as to how internal controls are assessed in both the Compliance Monitoring function and the Enforcement function. Such a sweeping change in NERC's Compliance Monitoring and Enforcement Program should not be permitted to take effect based on the unilateral posting of an amended guide, but should be established in a transparent process that incorporates stakeholder input.

This new expectation for registered entities to provide internal controls during compliance monitoring is an unnecessary and significant increased burden on region staff and registered entities. Approximately 80% of non-compliance is already self-reported, so there is no need to require this additional workload for region staff or registered entities. Registered entities are still faced with a zero tolerance expectation to prove, with evidence, that they comply with NERC standards. Now they have the added expectation of documenting internal controls for a regulator to review. We ask that the Board assess the reliability basis for this sweeping change and take into consideration the resources required to execute on yet another programmatic shift in compliance and enforcement.

Thank you for the opportunity to provide this policy input.