

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

North American Electric Reliability Corporation) Docket No. FA11-21-001

*REQUEST FOR REHEARING
OF THE NORTH AMERICAN ELECTRIC RELIABILITY CORPORATION*

Pursuant to section 313(a) of the Federal Power Act (“FPA”), 16 U.S.C. § 825l(a), and Rule 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.713, the North American Electric Reliability Corporation (“NERC”) hereby requests rehearing of the May 4, 2012 Letter Order (“May 4 Letter Order”) issued by the Director, Office of Enforcement (“OE Director” or “Office of Enforcement”) in this proceeding.

BACKGROUND

On August 22, 2011, the Division of Audits (“Audit Staff”) opened an “economy and efficiency” audit of NERC. After months of discovery and site interviews that consumed thousands of man hours, on March 23, 2012, Audit Staff released a Draft Audit Report that included 11 major findings and 42 recommendations and spanned 85 pages in length. Audit Staff gave NERC 15 days to respond and informed NERC that, if it had concerns with the report, they should be raised before its response was submitted. NERC requested an extension of time and was given a total of 30 days to respond.

On April 23, 2012, NERC submitted its response to the Draft Audit Report, including (i) a memorandum requesting the assistance of the senior leadership of the Office of the General Counsel, Office of Electric Reliability, and Office of Enforcement to resolve the issues on a coordinated and uncontested basis; (ii) a 59-page Response to the Draft Audit Report that, *inter alia*, offered to support, with certain important modifications, 34 of the 42 recommendations; and

(iii) a Blackline of the Draft Audit Report proposing changes to correct the more significant factual errors and incorporate NERC's proposed recommendations.

Eleven days later, on the eve of the Board of Trustees' quarterly public meeting, the OE Director issued a Final Audit Report that rejected virtually all of NERC's proposed changes to the factual findings and declined to accept the language of 30 of NERC's proposed recommendations.¹ The May 4 Letter Order also ordered NERC to make a compliance filing regarding recommendations that were allegedly uncontested and further directed NERC to take certain actions with respect to preserving its rights to a hearing or seeking rehearing. May 4 Letter Order at 3-4. The May 4 Letter Order stated that the OE Director had "delegated authority" to take "final agency action" in the matter. *Id.* at 4.

STATEMENT OF ISSUES AND SPECIFICATION OF ERRORS

1. The Office of Enforcement did not have delegated authority to take final agency action in this matter. The delegations set forth in 18 C.F.R. § 375.311(j) apply only to contested audits subject to section 301 of the FPA, which concerns "licensees" and "public utilities," not NERC acting as the Electric Reliability Organization ("ERO"). The Commission has declined to adopt procedures for Commission audits of the ERO. *Procedures for Disposition of Contested Audit Matters*, Order No. 675, FERC Stats. & Regs. ¶ 31,209 (2006), *order on reh'g and clarification*, Order No. 675-A, FERC Stats. & Regs. ¶ 31,217. There are therefore no procedures that could have been delegated to the OE Director.

2. Even if the OE Director had delegated authority in this matter, the OE Director erred in picking and choosing which NERC proposals it would accept and what procedures would apply to them. NERC made a comprehensive proposal to avoid a contested audit in this proceeding. The proposal was akin to a settlement offer that could not be accepted in part and rejected in part by OE acting unilaterally. *S. Natural Gas Co.*, 72 FERC ¶ 61,322 at 62,356 (1995) ("[P]arties cannot pick and choose among the various elements of the Settlement[] . . . , obtaining the benefit of those provisions which are favorable to them while continuing to litigate those which are not.").

¹ The May 4 Letter Order states that there are 17 uncontested recommendations (May 4 Letter Order at 3), but the Final Audit Report accepts the actual language proposed by NERC in only 12 total instances.

ARGUMENT

I. THE OE DIRECTOR DID NOT HAVE DELEGATED AUTHORITY TO ACT

The OE Director does not have delegated authority with respect to Commission audits of the ERO conducted pursuant to section 215 of the FPA. The OE Director's delegated authority is limited to contested audits that concern public utilities and hydro licensees under Parts I and II of the FPA. The relevant regulation makes this clear, stating that the OE Director has authority only to "sign audit reports involving jurisdictional companies, (1) If the company agrees with the audit report, or (2) If the company does not agree with the audit report, provided that any notification of the opportunity for a hearing required *under Section 301(a) of the Federal Power Act . . . accompanies the audit report.*" 18 CFR 375.311(j) (emphasis added). This language clearly indicates that the delegated authority does not extend to the Commission's jurisdiction over NERC as the ERO because section 301(a) of the FPA applies only to "licensees" and "public utilities," not to NERC as the ERO. In fact, the only delegation to the OE Director relating to the ERO provides him authority to "[d]irect the Electric Reliability Organization . . . to provide such information as is necessary to implement [FPA] Section 215(e)(2)." *Id.* § 375.311(u).

The OE Director does not have delegated authority regarding section 215 audits of the ERO because the Commission has not yet adopted regulations governing them. Rather, its regulations concerning FPA audits specifically exclude section 215 audits concerning the ERO. *Id.* § 41.1(a). In Order No. 675, the Commission declined to add section 215 audits to its Part 41 regulations, stating "[we] may reconsider this decision after an ERO is certified." FERC Stats. &

Regs. ¶ 31,209 at P 21. Since that time, the Commission has not adopted any such regulations. There are therefore no procedures to delegate to the OE Director.²

II. EVEN IF THE OE DIRECTOR HAD DELEGATED AUTHORITY IN THIS MATTER, THE OE DIRECTOR ERRED IN SELECTIVELY ADOPTING AND REJECTING ELEMENTS OF A COMPREHENSIVE PROPOSAL OFFERED BY NERC

Even if the OE Director had delegated authority, he did not exercise that authority properly. The May 4 Letter Order purported to make findings on which audit recommendations were contested and which were uncontested, ordered NERC to make a compliance filing regarding the recommendations deemed uncontested, and directed NERC to take certain actions with respect to preserving its rights to a hearing as to contested matters. May 4 Letter Order at 3-4. In doing so, the May 4 Letter Order mistakenly assumed that the Office of Enforcement could pick and choose which proposals to accept or reject and which procedures would apply to one set versus the other. This is not consistent with NERC's proposal to negotiate in good faith with the Office of Enforcement in an effort to achieve an *uncontested audit on all issues*. In this respect, NERC's proposal was akin to a settlement offer that could not be accepted and rejected in part. *S. Natural Gas Co.*, 72 FERC ¶ 61,322 at 62,356 (“[P]arties cannot pick and choose among the various elements of the Settlement[] . . . , obtaining the benefit of those provisions which are favorable to them while continuing to litigate those which are not.”); *see also Valley Disposal, Inc. v. Cent. Vt. Solid Waste Mgmt. Dist.*, 71 F.3d 1053, 1059 (2d Cir. 1995) (finding that “district courts possess considerable discretion to accept or reject settlement agreements, [but that discretion] does not authorize courts to exercise a ‘line-item veto’ over those agreements”).

² The May 4 Letter Order implicitly recognizes this because, unlike letter orders issued in contested proceedings under other sections of Part II of the FPA, the May 4 Letter Order does not refer to the Part 41 procedures for contesting audit determinations in such matters. *Compare* May 4 Letter Order at P 7 *with ITC Holdings Corp.*, Docket No. PA10-13-000, Letter of Norman C. Bay at P 6 (Sept. 30, 2011).

As NERC's Response to the Draft Audit Report stated:

The Board and NERC's management sincerely hope that there will be no need to decide what procedures should apply in the event this audit became contested. Rather, we hope that, working with Commission Staff, we can reach agreement on *all* the recommendations, thereby rendering the audit effectively uncontested and eliminating any need to resolve disputes over the findings. In that event, Audit Staff would issue a final Audit Report to NERC, NERC would review it and respond in writing that it agreed with the recommendations but disagreed with many of the findings (and noting the reasons therefor), and *the Commission* would then issue an order approving the recommendations without endorsing those disputed findings.

NERC Response to Draft Audit Report at 9 (Apr. 23, 2012) (emphasis added). NERC reserved its procedural rights in the event that some disputes could not be resolved, *id.*, but did so with the expectation that the Office of Enforcement would negotiate in good faith to achieve an uncontested audit and, consistent with its general practice, provide NERC an opportunity to review any revised recommendations. Regrettably, this did not happen and the Final Audit Report was issued without even a meeting being held with NERC.

This was in contrast to the normal approach taken in Commission audits. For example, in the most recent contested audit under Part II of the FPA, the following procedures were used: (i) a draft report was sent to the company that was the subject of the audit; (ii) the company responded in writing with its objections and proposed changes; (iii) the Office of Enforcement met with the company to discuss its response; (iv) the Office of Enforcement conducted a further site visit; (v) the Office of Enforcement prepared a revised draft report that was sent to the company for its further review; and (vi) at the end of a *seven-month period* of negotiations, the OE Director issued a final audit report. *See ITC Holdings Corp.*, Docket No. PA10-13-000, Letter of Norman C. Bay (Sept. 30, 2011).³ Here, in stark contrast, the Office of Enforcement

³ *Id.* at 1 ("Staff initially informed ITC Holdings of the audit findings and recommendations in a draft audit report on February 8, 2011. ITC Holdings provided a draft response on February 23, 2011. Representatives from the
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declined to meet with NERC regarding its response to the Draft Audit Report and, instead, issued a Final Audit Report *eleven days later*. This rushed process (apparently designed to coincide with the eve of NERC's Member Representatives Committee and Board of Trustees meetings on May 8-9, 2012) produced a Final Audit Report that contains so many errors that it is difficult to understand the Office of Enforcement's position on a wide range of matters.⁴ This is regrettable and ironic for a Final Audit Report that is so critical of NERC's internal controls.

The Office of Enforcement therefore erred in assuming that it could pick and choose which recommendations to treat as contested or uncontested and then unilaterally determine which procedures would apply to each. NERC submitted a comprehensive proposal in good faith and we did not intend that it be treated in this manner, particularly without even any discussion occurring concerning NERC's proposals before the Final Audit Report was publicly released. Thus, all of the recommendations should be treated as contested and subject to the

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Division of Audits met with ITC Holdings officials and its outside counsel on March 10, 2011 to discuss the draft audit report and ITC Holdings' draft response. Soon after, audit staff conducted an April 26-28, 2011 site visit and issued subsequent discovery. In response to the discussions and discovery, the draft audit report was revised and sent to ITC Holdings on June 20, 2011." Moreover, even in uncontested audits, the final report often is the result of multiple exchanges of draft reports. See, e.g., *W. Elec. Coordinating Council*, 132 FERC ¶ 61,149 at 10 (2010) (summarizing multiple exchanges of audit drafts and discussions between Audit Staff and WECC); *Tex. Reg'l Entity*, 130 FERC ¶ 61,025 at P 10 (2010) (summarizing similar drafting history); *Fla. Reliability Coordinating Council, Inc.*, 131 FERC ¶ 61,262 at P 9 (2010) (summarizing similar drafting history). This is why so many operational audits are uncontested.

⁴ We note just four examples to illustrate the resulting confusion. *First*, the May 4 Letter Order states that there are 17 uncontested recommendations (May 4 Letter Order at 3), but the Final Audit Report accepts the language of only 12 of NERC's proposed recommendations. *Second*, the Final Audit Report's recommendation regarding a compliance plan is stated three different ways the three different times it is repeated. Compare May 4 Letter Order at 3 (giving NERC 60 days to submit a compliance plan) with Final Audit Report at 12 (giving NERC 30 days to submit a compliance plan) and Final Audit Report Appendix B at 19 (giving NERC 60 days to submit *quarterly reports*, but not referencing a compliance plan at all). *Third*, Recommendation No. 19 is stated two different ways, one of which is replete with errors. Compare Final Audit Report at 9 with *id.* at 50. *Fourth*, the May 4 Letter Order does not even include a date by which NERC must notify the Commission of its request for review. May 4 Letter Order at 3-4 ("If NERC does not notify the Commission of its request for review within [sic] days, NERC may be deemed to have acquiesced to the audit findings and recommendations").

procedures proposed today by NERC in its Statement on Procedures filed in this proceeding. If the Commission adopts this Statement on Procedures, it will moot this request for rehearing.

CONCLUSION

Wherefore, for the foregoing reasons, NERC respectfully requests that Commission grant rehearing or, in the alternative, adopt the Statement on Procedures and dismiss this petition as moot.

Gerald W. Cauley
President and Chief Executive Officer
North American Electric Reliability Corporation
3353 Peachtree Road
Suite 600, North Tower
Atlanta, GA 30326
(404) 446-2560
(404) 467-0474 – facsimile

David N. Cook
Senior Vice President and General Counsel
Rebecca J. Michael, Associate General Counsel
for Corporate and Regulatory Matters
North American Electric Reliability Corporation
1325 G Street, N.W., Suite 600
Washington, D.C. 20005
(202) 400-3000
(202) 644-8099 – facsimile
David.cook@nerc.net
Rebecca.michael@nerc.net

Respectfully submitted,

/s/ _____
John S. Moot
Gerald L. Richman
Skadden, Arps, Slate,
Meagher & Flom LLP
1440 New York Avenue, N.W.
Washington, DC 20005
(202) 371-7890
(202) 661-9019 – facsimile
John.moot@skadden.com
Gerald.richman@skadden.com

Owen E. MacBride
Schiff Hardin LLP
233 South Wacker Drive, Suite 6600
Chicago, IL 60606
(312) 258-5680
omacbride@schiffhardin.com

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