

*Your Immediate Comments Are Essential to the Continued Success
of the Industry Self-Regulatory Organization Model*



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To: NPCC Full and General Members

Subject: Industry Outreach from NPCC on NERC's Future Direction

Ladies and Gentlemen:

The North American Electric Reliability Corporation (NERC) has proposed a number of expansions to the scope of its activities that could:

- (a) reduce the critical role of industry stakeholders in directing reliability initiatives;
- (b) erode the delegated authorities of Regional Entities;
- (c) be duplicative of Reliability Coordinator activities; and
- (d) radically increase reliability assurance costs with little to no associated reliability benefits.

NERC is currently contemplating an approximate 50% increase to its staff to move into areas inconsistent with its mission and to modify its operations prior to the completion of a FERC mandated assessment of its existing processes. This surge in staff is being considered for inclusion in NERC's 2010 Business Plan and Budget which has a preliminary \$15 million increase in total budget currently under development.

It is important to have industry opinions and input provided to the NERC Chairman of the Board, the NERC President and CEO, and the Chairman of NERC's Finance and Audit Committee to assist the NERC Board of Trustees in providing the vision necessary for NERC to manage its current resources at this critical juncture.

The Decentralized Reliability Assurance Model Envisioned in EPCRA 2005

The Energy Policy Act of 2005 drove the creation of an international Electric Reliability Organization ("ERO") which has the ability to develop and enforce reliability standards; has established rules to assure its independence, while assuring fair stakeholder representation and balanced decision making; and, authorization to enter into agreements with Regional Entities to delegate authority. NERC, as the certified ERO, initially leveraged existing decentralized Regional Entity resources and industry technical expertise to perform delegated authorities in a mandatory compliance environment. With a decentralized model, each layer adds value and has its own unique set of responsibilities and authorities. A decentralized model, emphasizing

implementation on a local basis, is essential to reliability. The bulk electric system operates differently in the Southwest as compared with the Northeast and the bulk system users, owners, and operators have different issues to resolve, and may have different means to resolve them (market versus non-market, public versus investor owned utilities, retail versus non-retail). Local knowledge is a key benefit in the decentralized model.

Utilization of the Decentralized Model

In order to be successful, NERC must refocus its efforts towards providing necessary guidance and establishing proper oversight controls, to assure that implementation in a decentralized manner can deliver consistent reliability outcomes. Identical results in compliance and enforcement may not be achieved due to diverse facts and circumstances coupled with the judgment necessary to exercise discretion in these decisions, but the consistent programmatic objective of enhancing reliability needs to be provided by NERC.

Any near term performance issues in standards development and the compliance and enforcement areas are related to implementation, rather than the design of the self regulatory model. NERC needs to better align its business planning with decentralized implementation. Fundamentally, NERC must establish the systems, procedures and processes to successfully mature the decentralized model and truly leverage the existing resources and knowledge within the industry as well as the Regional Entities to encourage the realization of the model's true benefits.

As an unintended and costly consequence of lack of guidance and oversight controls, NERC duplicates (e.g. shadows Regional Entity staff on compliance matters and performs de novo reviews of enforcement decisions) as a means for oversight rather than instituting effective, centralized guidance and controls. Effective guidance, such as establishing written planning procedures for the conduct of compliance audits, and developing consistent systems to manage information are essential elements for successful utilization of the decentralized model and are fundamental to exercising effective oversight. Additionally, NERC should coordinate comprehensive training for industry and Regional Entity representatives to establish a common view towards standards development and compliance and enforcement. Current inconsistency issues are the direct result of an inadequate central training program. By establishing a comprehensive training program, NERC can provide guidance in implementation.

This refocused NERC would enable the Regional Entities to concentrate their efforts on the ground to responsibilities of the delegation agreements and Canadian provincial Memoranda and Agreements. NERC should appropriately be the originator of central systems, procedures and processes. Initial NERC discussion of 2010 business planning seems to be centralizing the very aspects where decentralization works best such as investigations, audits and enforcement, while leaving areas which should be centralized such as systems, procedures, and process development unaddressed.

In summary, NERC needs to bolster the skills and tools necessary in order to improve implementation of the intended decentralized model rather than rely on its past practices. More effective guidance and oversight controls coupled with clarity of roles and responsibilities will drive better, more consistent results in a decentralized model.

For your background information, the following comments were provided to NERC following approval at the NPCC Board of Directors, at its April 28th, 2009 meeting. NPCC supports:

- An industry Self Regulatory Organization (SRO) model in which significant industry input is valued and recognized as an important tool, and utilized effectively through streamlined processes
- An international reliability assurance structure which deploys the NERC independent Board to provide the vision and direction, the ERO to provide the guidance and oversight, and the Regional Entities to implement delegated responsibility and authority for provision of reliability services
- Robust Regional Delegation Agreements as effective and efficient vehicles through which to leverage essential region-specific industry expertise within the SRO model

Further, NPCC stressed that the continuing expansion of the scope of the ERO is unsustainable from both an economic and an implementation perspective.

Please email your comments to NERC's Chairman of the Board of Trustees, Mr. John Anderson at janderson@bigwheelpartners.com, NERC's President and CEO, Mr. Richard Sergel at rick.sergel@nerc.net and Mr. Bruce Scherr, Chairman of the NERC Finance and Audit Committee at bruce.scherr@informaecon.com. Your input should additionally be provided to me at eschwerdt@npcc.org.

Thank you for your prompt attention to this very important matter.

Very truly yours,

Edward A. Schwerdt

Edward A. Schwerdt
President and CEO

EAS:jm

cc: NPCC Board of Directors