

Developing a FERC Standards of Conduct Compliance Program

This paper serves to highlight the conflicting views of the challenge to comply with FERC’s Order 2004 (A, B, and C), Standards of Conduct for Transmission Providers (SOC). It also offers an alternative program that might help companies facing this challenge today. To illustrate the current industry approach to complying with the SOC we will use two fictitious companies as examples.

Stubborn Trouble Utility Company (STUC) has very good lawyers, always has. To hear *them* tell it, STUC has never lost a case in court or at a regulatory agency. When new regulations get proposed, STUC is at the forefront of organizing opposition to the new rule proponents. When regulations get passed, STUC disputes every detail- in court- of course, because STUC *does* have very good lawyers.

In-Control Electric (ICE) has good lawyers too. They may not be quite as worldly as STUC’s team of well-heeled attorneys, and they certainly could never claim the extensive trial experience that STUC’s lawyers have, but they are proud in their own right. When regulations seem imminent, ICE staffpersons are hard at work scrutinizing every detail of the changes—they won’t get caught on the back-end of the implementation curve.

The following chart depicts two very different approaches to complying with the SOC rules that were adopted in November 2003 and due by September 2004. Does one resemble your company?

<u>Event</u>	<u>STUC</u>	<u>In-Control Electric</u>
Notice of Proposed Rule-Making	Organize a meeting of attorneys from other “opposition companies”.	Appoint a team of multi-disciplinary experts from around the Company.
Ongoing Rulemaking	Draft opposition briefs; file for injunctions; loosen the lawyer-lobbyists in Washington.	Ascertain rule impacts and develop alternative proposals for consideration by FERC.
Final Adoption of Rule (Order)	Orchestrate legal-fee cost-sharing “summit” to oppose implementation of rules.	Develop detailed implementation plan and resource matrix.
Pre-Deadline Implementation	File for exemptions; then file for exceptions; then file for extensions.	Execute all implementation activities; test effectiveness of team performance.
FERC Phase One Enforcement	Challenge FERC’s contention that STUC has not met initial implementation standards.	Received letter from FERC praising initial implementation efforts (postings).
Phase Two Enforcement (Audit)	Provide minimal data request documentation; challenge FERC’s authority; Negotiate settlement agreement with FERC.	Prepared full SOC Compliance Manual and conducted assessment of current and continuous compliance.
Post-Audit	Draft memo regarding new <i>mandatory</i> compliance and reporting procedures ordered by FERC (post-audit).	FERC reviews Compliance Manual. Approves compliance without exception.
Ongoing	Quarterly and semi-annual FERC audits.	Annual review of Compliance Manual.

Complying with FERC’s SOC: The Risk Management Approach

The risks of non-compliance with the SOC are apparent. Fines, profit disgorgement, assessments, and even criminal penalties can loom large. Worse yet, some companies are going to have to change the way they do business- FERC will most likely order mandatory compliance measures that includes practices and measures that may run contrary to your company’s business operations. The costs for implementing mandatory compliance procedures can be greater than the nominal fines that have been doled out (the maximum to date has “only” been about \$22 million).

If you are accused of being in serious violation of an SOC regulation, what will your defense be? Can you claim (and demonstrate) that you were vigorously trying to be fully-compliant and practical in your procedural implementation? Are you aware that FERC considers (in their enforcement approach) whether companies have been pro-active? Of course you are, and that’s why you’re going to follow an SOC Compliance Blueprint.

THE SOC COMPLIANCE BLUEPRINT

Order 2004 (A, B, and C) provides regulations that can be found in the Code of Federal Regulations (18 CFR Part 358). When these rules are scrutinized, a base set of **38** or so actionable elements emerge as the focal points of any organized compliance approach. Though there seems to be overlap between some of these elements, an examination reveals that subtle differences make each element an undertaking itself.

Step One- The Blueprint Background

The SOC rules can be both non-specific yet very detailed in how companies should comply. This frustrating paradox lies at the heart of FERC's unique approach: whether companies are actually continuously complying, or whether they are making a negligible effort. This performance-based outcome approach can be discerned in recent regulatory regimes (such as the extensive Sarbanes-Oxley rules) and appears to be the modus operandi of future regulatory relationships.

Therefore the Blueprint Background needs to have the essence of responsibility and accountability built-into the structure itself. Every element of the rule needs to have a matching "owner"- and not the same Chief Compliance Officer (CCO) for everything. Compliance needs to be pushed-and-pulled *in-balance*, or else risk having the entire structure collapse under the weight of internal hubris. That means pulling a team together. It means having executive sponsorship and management investment and accepting the fact that changes will have to be made.

Step Two- The Dramatis Personae (Cast)

Complying with the SOC requires having a *leader* at the helm of the program. Unfortunately most companies have assigned compliance to attorneys, pre-retiring mid-managers or whoever "had the time". Often they will appoint a "senior" manager as the CCO; however these assignees rarely have the time or wherewithal to actually *do* the work- they are designators only. The crucial process of aligning corporate governance to policies and practices can hardly be administered by personnel that do not have the experience, authority and resources of executive management.

In a performance-based regulatory system, company personnel responsible for implementing compliance will be called upon to do more than what had been forecasted; to inspire others to make exceptional contributions to the effort; to ensure substantial and judicious progress when resources and time are in short supply. This requires a solid leader- not necessarily a familiar face, but someone that can muster a *passion* for managing the program.

Step Three- Fail to Plan/Plan to Fail

The old adage about fail to plan/plan to fail was meant for SOC compliance. For every one of the actionable elements of the SOC, a definitive design is required:

1. **Develop compliance procedures-** every detail of each step of the compliance procedures must be thoroughly developed and tested. This requires task-track planning where the compliance process is subjected to a work-flow and decision-tree evaluation.
2. **Create procedural controls and performance monitoring methods-** developing proper monitoring controls produces crucial compliance metrics that senior management can use to compare the risks of non-compliance to the benefits of a particular compliance measure.
3. **Implement a reporting process to document ongoing compliance-** it produces a record of compliance-with proof -in the event of a disagreement with FERC. It also keeps management constantly informed of the effectiveness of the compliance procedures.

Step Four- The Compliance Manual

Every company should have one of these for each regulatory regimen- most firms do! The SOC is no different- the procedures for compliance must be laid out in a highly usable, yet comprehensive format that leaves little room for misinterpretation or deviation from approved procedures.

Many of the 38 elements of the SOC have overlapping implementation issues. Therefore the SOC can be segmented into three groups of six topical areas each:

- 1-6: Personnel-oriented Guidelines;
- 7-12: Information-oriented Guidelines; and
- 13-18: Postings and Tariff-related Guidelines.

The format for each of the 18 Guidelines includes relevant procedures and information about the company's expectations from personnel and business units. These may include:

- 1. Company Policy- firm and un-ambiguous;
- 2. References to SOC rule elements and posted Written Procedures content;
- 3. Accountability Matrix- who is expected to...;
- 4. Compliance Procedures: describe in narrative AND as flow chart or decision tree;
- 5. Monitoring and Control description: how continuous compliance is ensured;
- 6. Reporting Procedures and Contingency Plan: how failure to perform becomes visible;
- 7. Forms: copies of tracking or report forms used to facilitate implementation.

Include Task Lists, Compliance Schedules, Resource Reports and other components; the company will have a fairly good handle on managing the risks of non-compliance.

Step Five- Relax, you're doing all you can do

There are a finite number of compliance measures that can be taken with the SOC. You have either done nothing, are in-development or you have completed implementing a comprehensive compliance program. If you are done you can comfort yourself that everything to protect you and your company has been as competently managed as all other business risks that energy companies face today.

ProComply is a Regulatory Services Provider specializing in the FERC Standards of Conduct and affiliate transaction rules. Our services include:

- * Compliance training- online customized SOC training at multiple learning levels;*
- * Independent auditing- a thorough assessment of your current state of compliance and the steps you need to implement to ensure continuous compliance:*
- * Compliance Programs- includes complete set-up of an internal compliance program and Compliance Manual. Our website is at www.ProComply.com.*