

December 17, 2013

MEMORANDUM TO THE GOVERNANCE COMMITTEE

FROM THE VICE PRESIDENT and CHIEF ETHICS & COMPLIANCE OFFICER

SUBJECT: Recent Developments and Status of NYPA's Ethics & Compliance Program – Governance Committee Report

ETHICS and COMPLIANCE

SUMMARY

The Ethics and Compliance Office advises NYPA's trustees, officers and employees on the legal, regulatory and NYPA Code of Conduct ethics and compliance standards relating to NYPA's employees and operations. It coordinates the investigation of allegations and concerns involving NYPA's assets and employees. This report highlights significant developments in NYPA's ethics and compliance program for the period July 23, 2013 to December 17, 2013.

BACKGROUND

The principal substantive issues arising under the NYS ethics laws and NYPA's Code of Conduct investigated or researched since the most recent Governance Committee report on July 23, 2013 included inquiries related to employees' engaging in outside activities and/or business endeavors and issues concerning conflicts of interest, gifts, post-employment restrictions and "re-hire" reviews related to former employees.

The Office provides annual training to all trustees, officers and employees to reaffirm NYPA's commitment to prevailing ethics principles and raise awareness of the laws and regulations with which all NYS public employees are required to comply. Annual review of and certification to the NYPA Code of Conduct is implemented as an additional measure to reinforce acceptable business and professional conduct. The Office also coordinates required training for designated employees to comply with the Federal Energy Regulatory Commission's (FERC) Standards of Conduct relating to its transmission and energy marketing functions and FERC Rules designed to prevent manipulation of energy markets.

DISCUSSION

Ethics Caseload

The Office reviewed 89 cases since the last report to the Governance Committee. This level of activity represents an upward trend in case volume and included reviews in the following categories: 1 allegation, 3 appearances of impropriety; 4 conflicts of interest; 1 Financial Disclosure question; 2 general inquiries; 18 gifts questions; 14 outside activities and 24 outside employment reviews; 2 political activity/donor inquiries; 7 post-employment questions; 1 securities question; 11 issues related to unwarranted privilege and 1 assessment relating to

appropriate use of NYPA assets. These cases originated from all NYPA facilities. The higher volume of inquiries can be attributed in part to the multiple mandatory live ethics training sessions provided at headquarters and the operating facilities during this reporting period. The Code of Conduct review and certification process also contributed to an increase in cases and ethics guidance provided to the Trustees and employees.

Three employees from an operating facility sought to engage in outside employment designing and installing solar panel systems on residential properties. During the course of the mandatory live ethics training, these individuals raised questions relating to the Public Officers Law §73(7)(a)(iv) example which asserted that state employees could not appear before another state agency in a professional capacity for purposes of “the obtaining of grants of money or loans”. The employees intended to facilitate financial incentives from the New York State Energy Research and Development Authority (NYSERDA) for the benefit of residential customers. NYSERDA’s program requires the use of pre-approved installers in order for homeowners to qualify for the incentive program. All three employees completed NYSERDA’s training certification program at a significant personal cost prior to being approved by NYSERDA as certified installers. At no time was the public informed that state employees could not participate in the program to become certified installers or engage in the financial incentive application process on behalf of qualified homeowners.

One of NYPA’s affected employees sought and received an informal advisory opinion from the New York State Joint Commission on Public Ethics (JCOPE) which advised him that he would be in violation of the Public Officers Law were he to appear before NYSERDA to request financial incentives for his customers. All employees who sought ethical guidance on this issue were notified of the JCOPE opinion and have since suspended work in this area. NYPA is preparing to engage NYSERDA to explore a creative solution which may enable the NYSERDA program to proceed with participation by qualified and certified state employees. One potential option may be to amend the rules of participation such that the available financial incentives be issued directly to the residential customer rather than as a pass-through by the installation vendor. This will uphold the Public Officers Law directive restricting state employees from appearing before another state agency for the solicitation of grants of money or loans.

The mandatory ethics training also focused on a relatively new interpretation of the post-employment restrictions, referred to by JCOPE as the “reverse two year bar”. Founded on a JCOPE advisory opinion, the reverse two-year bar seeks to restrict new state employees from providing an unwarranted privilege or advantage to the employees’ former private sector employers. The Office has reviewed several of these cases this reporting period, including one in which NYPA hired a new employee from a large, international firm which does business with NYPA. The Office determined that the new hire may perform work involving his former employer during the two year period because the work related to a previously designed and installed technology and the new hire had worked for an unrelated department located in a different geographical region while employed by the NYPA vendor. The employee was advised that while he could perform work related to this prior installation, he could not participate in the evaluation of any bids or proposals, or the award of any contracts relating to his former employer.

Collaboration with the New York State Inspector General's Office

The Office continues to collaborate with the NYS Inspector General's Office on investigations of allegations and complaints involving NYPA employees and business partners. Issues of corruption, fraud, criminal activity, conflicts of interest or abuse by state officers and employees relating to their office or employment, or by anyone having business dealings with covered agencies, are included within the Inspector General's Office jurisdiction. Details of pending cases will be provided during the Governance Committee Executive Session upon request.

In addition to working with the Inspector General's Office concerning ongoing investigations, NYPA sought and received approval from the Inspector General for her office to provide investigations training in the White Plains Office to NYPA staff from the Ethics & Compliance Office, Human Resources, Corporate Security, Internal Audit and the Technical Compliance departments. This training was held on Tuesday, December 3, and was designed to provide participants greater knowledge and understanding of investigative techniques in the public sector, including the planning, interviewing, documentation and reporting of investigation findings and recommendations.

Training and Outreach

The Public Integrity Reform Act of 2011 required that all Trustees and employees who participate in the Financial Disclosure Program administered by JCOPE receive a live comprehensive ethics training. NYPA's Chief Ethics and Compliance Officer, Joseph Gryzlo, was certified to conduct the training for the approximately 400 NYPA Trustees and employees required to participate. Multiple training sessions were held in the White Plains Office and at the operating facilities throughout the months of May through October.

A compliance training report will be submitted to JCOPE detailing training statistics for NYPA on or before January 31, 2014.

In addition to fulfilling this compliance training requirement, the Office extended this training opportunity to all NYPA employees to satisfy its own internal annual ethics training commitment. To date, approximately 915 employees have participated. The remainder of employees will either receive the training as a computer based presentation or in hard copy, primarily for those bargaining unit employees who do not have regular access to a computer or work in the field.

The Office also used these training sessions to facilitate the annual Code of Conduct Certification process. These annual certifications will be scanned and stored in LiveLink per the records retention policy.

The Office is sponsoring a poster awareness campaign in conjunction with several other business units, including Human Resources and Technical Compliance. The posters will focus on the concept of confidentiality and its requirements under the law. Featured topics will include investigations, employees' protected health information, Affirmative Action and the North American Electric Reliability Corporation's Reliability Standards. It is anticipated that each poster will appear in all NYPA facilities beginning in the first quarter of 2014.

Matters before the Joint Commission on Public Ethics

In October, 2013, Letizia Tagliafierro was named JCOPE's new Executive Director, replacing Ellen Biben. Ms. Tagliafierro has previously served as JCOPE's director of investigations and enforcement.

"Project Sunlight" Update

NYPA employees and Trustees continue to identify and document required "covered appearances" under Project Sunlight in a timely manner. To date, NYPA has reported more than 200 appearances in the official Project Sunlight database, which was developed to enable the public to view who is seeking to do business with state agencies and authorities. NYPA was recognized for its compliance at a recent Project Sunlight liaison meeting and continues to be among the highest reporting state entities. This initiative remains a priority for all NYPA staff.

RELIABILITY STANDARDS COMPLIANCE

SUMMARY

This report highlights important aspects of NYPA's reliability standards compliance management program for the period July 23, 2013 to December 17, 2013. A brief background statement is followed by discussion of specific reliability standards-related topics affecting the enterprise.

BACKGROUND

Following the 2003 Northeast blackout, the Energy Policy Act of 2005 was passed and gave the Federal Energy Regulatory Commission ("FERC") the power to establish mandatory standards for electric reliability. FERC named the North American Electric Reliability Corporation ("NERC") as its Electric Reliability Organization ("ERO") and charged it with developing and enforcing reliability standards. The Northeast Power Coordinating Council ("NPCC") is NERC's enforcement agent for the Northeast U.S. NERC established an organization and processes for developing, implementing and enforcing standards. The initial set of standards became enforceable on June 18, 2007. Since then, the standards have continued to be expanded and revised to address known gaps in the standards or gaps discovered from lessons learned from analyses of more recent system disturbances and blackout events.

NYPA is currently registered, under the NERC functional registration model, as a Transmission Owner, Generator Owner, Generator Operator, Purchasing and Selling Entity, and Load Serving Entity. Recently, NYPA requested de-registration as a Load Serving Entity. Under these registrations, NYPA is subject to 115 standards containing 379 requirements. The standards cover a wide range of NYPA's operation and maintenance activities and processes. In addition, NYPA is subject to some more stringent standards and reliability requirements established by NPCC.

DISCUSSION

NERC Reliability Standards Compliance Enforcement Actions

During the reporting period, NYPA submitted to NPCC three (3) self-reports of possible NERC Reliability Standards compliance violations pursuant to NYPA's NERC registrations. In addition, during this period, NPCC Enforcement staff concluded three (3) enforcement actions. There are currently nine (9) open enforcement actions related to possible violations of the standards; all of them self-reported to NPCC. All the associated mitigating activities for the nine (9) open actions have been completed and are being reviewed by NPCC.

Possible Violation Concern Investigations

During the reporting period, Technical Compliance initiated investigations of five (5) possible NERC Reliability Standards compliance concerns identified by the staff pursuant to an internal procedure entitled "Possible NERC Reliability Standards Compliance Violation." Five (5) investigations that were in process at the beginning of the reporting period were closed; three (3) resulted in self-reports of possible violations and two (2) of the concerns were determined not to be compliance issues.

This internal process is viewed by the regulator as evidence that NYPA has a strong internal compliance program.

Self-Certifications of Compliance

During the reporting period, NYPA successfully completed two (2) self-certifications of compliance pursuant to NYPA's NERC registrations for the NERC reliability standards; one for Critical Infrastructure Protection (CIP) standard *CIP-001-2a – Sabotage Reporting* and one for the Interconnection Reliability Operations and Coordination (IRO) standard *IRO-005-3a - Reliability Coordination - Current Day Operations*. Technical Compliance has established a rigorous process to ensure that compliance evidence is updated before NYPA self certifies compliance.

Compliance Audits

NPCC conducted a spot check audit of NYPA's compliance with NERC reliability standard *PRC-001-1 – System Protection Coordination* from July 29, 2013 to August 3, 2013. The audit was completed in October. There were no violations identified and no areas of concerns or corrective recommendations noted. NYPA received a draft audit report from NPCC on October 24, 2013.

NERC Reliability Assurance Initiative (RAI)

NYPA, along with other generation and transmission companies in North America, including Large Public Power Council (LPPC) and American Public Power Association (APPA) members, has been actively supporting the NERC and NPCC in moving this important NERC program forward. In particular, NYPA was selected by NPCC to participate in two pilot programs to test new compliance monitoring and enforcement tools; one is focusing on methods for assessing a company's internal controls for managing compliance and one is focusing on new tools for processing minimal risk violations of the standards.

BULK ELECTRIC SYSTEM DEFINITION (BES)

The relevant background on this topic is contained in the July 31, 2012 report to the Governance Committee.

The Federal Energy Regulatory Commission (FERC) approved the new Bulk Electric System (BES) definition on December 20, 2012. The new definition will provide greater clarity and ensure consistency in identifying system elements across the nation's reliability regions and will require transmission assets above 100kV to be subject to the NERC Reliability Standards. NYPA staff continued work to identify any compliance gaps for 40 newly identified BES elements under NYPA's current NERC registrations.

As stated in the last report, the adoption of the new BES definition may require NYPA to register as a Transmission Operator (TOP) and/or a Transmission Planner (TP), which would require NYPA to demonstrate compliance with additional reliability standards. During the reporting period, NYPA continued to participate in meetings with the NYISO and the other NY Transmission Owners to assess new state-wide functional registration and compliance management impacts and actions pursuant to the new BES definition. NYPA staff having knowledge of these matters also met several times internally during the reporting period to further clarify the impacts on NYPA with respect to functional responsibility and compliance accountability for the TOP and TP Standards.

In addition, NYPA staff completed an assessment of potential Transmission Owner (TO) registration compliance gaps for its 40 newly identified BES elements. For the few gaps identified, a corrective action plan has been developed and is being implemented. During the reporting period, NYPA continued to hold bi-lateral meetings with National Grid and New York State Electric and Gas to address projected gaps in compliance for the TO standards for newly identified NYPA BES assets located within their substations. Similar meetings with Consolidated Edison and LIPA were held. NYPA and Con Edison reached agreement on Memoranda of Understanding for managing reliability compliance for the TO standards for the Sprainbrook Substation (Y49 transmission line) and the Astoria Annex Substation. In addition, NYPA engaged in bi-lateral discussions with other Transmission Owners to discuss the Transmission Operator (TOP) and Transmission Planning (TP) responsibilities and the impacts of Version 5 of NERC's Critical Infrastructure Protection (CIP) reliability standards on NYPA's newly identified BES assets located within their substations. These discussions are expected to continue until the end of the BES and CIP Version 5 implementation periods which end in 2015 and 2016, respectively.

NERC RECOMMENDATIONS TO INDUSTRY – Facility Ratings for Transmission Lines

During the reporting period, NYPA continued to implement its work plan for responding to NERC's October 7, 2010 "NERC Alert – Recommendation to Industry" requiring NYPA to review its current Facility Ratings Methodology for its solely- and jointly-owned transmission lines to verify that the methodology is based on actual field conditions (in particular, line clearances). As stated in previous reports, the assessment discovered about 260 line clearance discrepancies in NYPA's 1,400 miles of transmission lines; about 50 of which were on lines rated as high priority. All of the discrepancies on the high priority lines have been corrected. The remediation of discrepancies on the medium priority lines is in progress and is expected to

be completed in 2013. The remediation of discrepancies on the low priority lines is planned for completion in 2014. The next status report to NERC is due in January 2014.

CYBER SECURITY DEVELOPMENTS

During the reporting period, NYPA staff continued to monitor progress toward implementation of Version 5 of NERC's Critical Infrastructure Protection (CIP) reliability standards. On November 21, 2013 FERC approved the CIP Version 5 reliability standards and nineteen new or revised definitions related to the new standards. FERC's draft final rule also approved the implementation plan and the effective dates proposed by NERC. Therefore, Version 4 will not become effective and Version 3 will remain in effect until the Version 5 effective date of April 1, 2016.

The approved Version 5 of the Critical Infrastructure Protection (CIP) standards will have substantive impacts on NYPA's CIP compliance program. Staff is in the process of performing a classification assessment of those assets that will be affected by the revised standards to determine the scope and costs of the implementation plan that will ensure NYPA's compliance with the revised standards. Expenditure estimates for implementation of CIP version 5 have been included in the Operations budget plan for 2014-2015.

ENVIRONMENTAL, HEALTH AND SAFETY AUDITS

Summary

This report highlights aspects of NYPA's environmental, health and safety compliance audit program for the period from October 10, 2012 to December 17, 2013. Per the procedure for the program, reports to the Governance Committee are made annually. A brief background statement is followed by discussion of specific topics affecting the audit program.

Background

Since 2006, NYPA has conducted environmental, health and safety audits at its facilities to ensure that they are operated and maintained in compliance with applicable laws, regulations, permits, policies and procedures. The audit findings identified various regulatory, policy and preferred management practice deficiencies which are being addressed by appropriate staff. They are categorized into three (3) levels which are prioritized based on risk.

Overall, NYPA's facilities have maintained substantial compliance with environmental, health and safety laws and regulatory requirements. The findings are primarily administrative in nature or address housekeeping issues which do not rise to a high risk level.

Environmental Safety and Health Audits

Audits were conducted at the 500 MW Project, Plattsburgh Substation, Saranac Substation, Cumberland Head Substation and Ashokan Hydroelectric Power Plant. The audits are divided into program audits and comprehensive environmental, health and safety audits. Audits at the Niagara, Kent and Pouch Power Projects and the Astoria Annex Substation were deferred to 2014 because of staffing issues.

This year, the most significant findings have been at the Cumberland Head, Plattsburgh and Saranac Substations. At all three substations, documentation of annual inspections and training for lockout/tagout procedures for major equipment was not available. Documentation was provided following the audit. At the Cumberland Head Substation a ladder opening was not guarded. At the Plattsburgh Substation, electrical cabinets with energized conductors were open. Staff is remediating these issues.

The “Addendum to the Environmental Risk Assessment” to address health and safety compliance issues was finalized. Staff is preparing a scope of work to conduct a “Management System Audit” in 2014. Per the procedure for the program, the Internal Audit Committee will meet in the first quarter of 2014 to discuss the status of the program and suggestions to improve the program.

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