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To: Members of the Governance Committee

From: Joseph W. Gryzlo, Vice President, Labor Relations & Chief Ethics & Compliance Officer *Joseph W. Gryzlo*

Date: November 15, 2011

Re: Recent Developments and Status of the Ethics & Compliance Program

I. ETHICS UPDATE

A. Case Management

1. Current Reporting Period—September 27, 2011—November 15, 2011

The principal substantive issues arising under the Ethics laws and/or the NYPA Code of Conduct investigated or researched since the most recent Governance Committee report on September 27, 2011 include various requests to engage in outside employment and activities, appearances of impropriety or conflicts of interest, post employment restrictions and gifts inquiries. There have been twenty (20) inquiries during this period with an emphasis on ethics restrictions relating to outside employment and gifts.

2. Case Load Summary--Current Reporting Period

A NYPA engineer traveled to Italy for a Quality Assurance inspection and was provided ground transportation by a vendor while visiting a facility. The employee would have made his own arrangements but was informed that he should accept the vendor's transportation to the facility because travel in the area was difficult to manage and can be unsafe for those unfamiliar with the locale. Arrangements were made to bill NYPA for this service to avoid a violation of the ethics gifts restrictions.

A NYPA employee requested permission to engage in outside employment developing electric power system course curriculum and serve as an adjunct professor for Bismarck College, a school with which NYPA has a formal relationship through the Human Resources Talent Development group. The request to engage in curriculum development was approved after it was determined that no conflicts of interest existed. The approval to serve as a professor was conditioned on the employee and Bismarck College's commitment

to review class lists to ensure that no NYPA employees would participate in his classes. This would insulate the employee from violating NYPA's Code of Conduct (prohibition on selling good/services to NYPA) and other ethics considerations relating to conflicts of interest and appearances of impropriety.

During the aftermath of Hurricane Irene, a NYPA employee who found himself without power for several days asked a NYPA vendor with whom he had a longstanding personal relationship whether the vendor knew of any generators for rent in the marketplace. The vendor offered his own personal generator. The NYPA employee accepted the generator and later ascertained the daily rental cost through market research, and paid his friend for use of his generator. The NYPA employee was directed to maintain records of the payment.

3. Investigation Reporting

The Ethics and Compliance Office received a report from NYPA's Procurement Department which alleged improper payroll practices by certain NYPA vendors relating to their provision of temporary staff services to NYPA. The report was initially reviewed with the Law Department and then referred to NYPA's Internal Audit Department for investigation. The investigation substantiated that certain vendors had violated their contracts with NYPA and may have under-reported wages and taxes in connection with their employees who had been assigned to NYPA. The vendors were either paying their employees as independent contractors and/or providing them with per diem payments in violation of the NYPA contracts which required that only actual wages be paid to these employees.

As a result of this investigation, NYPA rescinded the contracts with two vendors and terminated the services of those vendors' employees who had been assigned to NYPA. In addition, the Law and Procurement Departments are revising certain contract language to strengthen internal controls.

B. MATTERS BEFORE THE COMMISSION ON PUBLIC INTEGRITY

1. Gifts Rules

The Public Officers Law gifts rules have been revised under the new Public Integrity Reform Act. The current gifts restrictions prohibit state employees from accepting anything above 'nominal' value, which has been interpreted by the Commission as equivalent to a cup of coffee or less. The new version of the gifts rule allows for up to \$15 in food or beverages and more clearly defines widely attended events and circumstances under which state employees may accept travel, lodging and meals without violating the gifts provisions. Additional guidance will be provided to employees.

2. "Project Sunlight"

This program establishes a new database which will aggregate information concerning all firms and individuals that appear before any state agency or authority in a representative capacity. It requires that all state entities track and provide information related to appearances for the purposes of procuring a state contract for property, goods or services; representing clients related to rate-making; representing clients in regulatory matters; representing clients in a judicial or quasi-judicial proceeding, and representing clients or customers in the adoption or repeal of a rule or regulation. This database will be maintained by the Office of General Services and be available for viewing and download via a webpage, subject to statutory confidentiality restrictions.

C. TRAINING AND OUTREACH

Ethics training relating to Outside Employment ethics considerations was finalized and will be issued to all Trustees, officers and employees in November. It will be provided through NYPA's computerized LMS training platform. For those employees who do not have regular computer access, copies of the training will be provided to them with the assistance of the Facility Human Resources and departmental staff during regular staff meetings. The annual Code of Conduct certification will accompany this training.

The Ethics & Compliance Office provided two additional training sessions since the last report to the Governance Committee. The first was a presentation to new supervisors as part of Human Resources' Supervisory Development Training and the second was a targeted training pertaining to privacy and confidentiality requested by a headquarters department manager to ensure that new and experienced staff members are fully aware of the requirements under the law and NYPA's Code of Conduct.

II. COMPLIANCE UPDATE

A. NERC Reliability

1. Northeast Power Coordinating Council (NPCC) Culture of Compliance Survey

In 2011, NPCC developed and conducted a Culture of Compliance Survey of its approximately 350 members and expects to have all results compiled by the end of this year. NPCC's goal and the analysis of its survey results is to identify and share best practices for managing compliance among its registered entities.

NYPA received a letter from NPCC on October 18, 2011 which summarized NPCC's assessment of NYPA's culture of compliance. NPCC concluded that

NYPA clearly has demonstrated that it meets or exceeds all minimum characteristics of a favorable culture of compliance. The promotion of a sound culture of compliance is consistent with FERC and Canadian enforcement agencies' philosophies that entities will be given credit with regard to penalties and sanctions if an effective compliance program is in place.

2. Load Serving Entity (LSE) De-Registration

NYPA registered as a Load Serving Entity under NERC's functional registration model in June 2007 when the NERC Reliability Standards became mandatory. NYPA registered as an LSE for its municipal customers and ALCOA, a NYPA industrial customer. In 2009, NPCC determined that NYPA's municipal customers should be registered as LSEs, not NYPA as acting on their behalf. These municipal customers have since registered as LSEs.

On December 10, 2010, NPCC notified ALCOA that it was reviewing the LSE registration applicable to ALCOA. NPCC has engaged NYPA and ALCOA in discussions and information requests, including applicable assets/ownership, metering points and load flow data. In March 2011, NPCC requested NYPA to provide a position paper on the LSE registration for the ALCO load. NPCC stated it would discuss this registration situation involving large industrial end user customers with its NERC regional counterparts to determine if either entity needs to be registered as a LSE. NPCC did not audit NYPA's compliance with the applicable reliability standards for LSEs during its June 2011 FERC Order 693 audit. NYPA submitted its position paper and additional requested information to NPCC on July 18, 2011 and is awaiting a response from NPCC.

3. NERC Recommendation to Industry – Facility Ratings for Transmission Lines

On October 7, 2010, NERC issued a "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). This Alert was issued as a result of vegetation contact by a transmission owner and NERC's subsequent discovery that the actual field condition of the transmission line differed from its design condition causing some facility ratings to be inaccurate or in question (e.g. violations of the codes for line-to-ground clearances). Pursuant to the NERC Rules of Procedure, all Registered Entities are required to report to NERC on the status of activities relating to this Recommendation. At the end of the assessment and remediation period, it is possible that some entities will be subject to enforcement actions. This is a significant undertaking by the Transmission Owners in North America.

NYPA was required to submit a plan to conduct an assessment and any necessary remediation of the issues identified in the recommendation. NYPA submitted its plan to NERC on January 18, 2011 with commitments to complete the required evaluations, reports and remediations. NYPA met with the New York

Independent System Operator (NYISO) on July 8, 2011 to discuss its assessment plan and the management of outages that might be required to mitigate any line clearance issues that are discovered. Since the submission of its plan, NYPA's assessment has progressed as planned. The consultants performing ground clearance studies of NYPA's transmission facilities issued an updated schedule confirming that all studies will be completed by the end of 2011. NYPA will meet again with the NYISO in January 2012 to discuss a mitigation strategy for any line clearance issues that are discovered.

4. Environmental, Health and Safety Audits

Since the last report to the Governance Committee, an environmental, health and safety audit was conducted at the Poletti Power Project Decommissioning site. Several findings were identified which related to required inspections under health and safety regulations and updating certain plans to notify agencies that the plant has been decommissioned.

Based on discussions with members of the Internal Audit Committee, the scope of the Southeast New York facilities 2011 audit has been confined to the requirements of the Resource Conservation and Recovery Act hazardous waste management activities. Audits have been conducted at the Hell Gate, Harlem River and Gowanus Power Projects. Very little hazardous waste is generated at these facilities. Good management practice findings were identified during the audits.

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