

Texas Regional Entity Update

Sam Jones
Interim CEO and President

Board of Directors

July 18, 2006



Corporate Governance

Texas Regional Entity Background

- ❑ ERCOT would like a division of ERCOT (Texas Regional Entity or “Texas RE”) to become the Regional Entity for the ERCOT Region
- ❑ ERCOT will need to submit a draft Delegation Agreement to NERC (the Electric Reliability Organization or “ERO”) by August 1, 2006 and negotiate a final Delegation Agreement by October 1, 2006
- ❑ To be selected as the Regional Entity, ERCOT must demonstrate that the Texas RE can meet the 5 ERO corporate governance requirements as follows:

Requirement 1 – Board Composition

- Requirement 1: The Regional Entity shall be governed by an independent board, a balanced stakeholder board, or a combination independent and balanced stakeholder board
 - ❑ ERCOT is governed by a combination independent and balanced stakeholder board, as required by Section 39.151 of PURA, as follows :
 - 5 independent Directors (unaffiliated with any market participant or “Unaffiliated,”) approved by the PUC for 3-year term;
 - 6 market participant representative Directors from each of the following market segments: independent generators, investor-owned utilities; power marketers; retail electric providers, municipally owned utilities, and cooperatives;
 - 3 consumer representative Directors (1 from the Office of Public Utility Counsel, 1 large commercial & 1 industrial);
 - CEO of ERCOT (as ex officio voting Director) and
 - Chairman of the PUC (as an ex officio non-voting Director)

Requirement 2 – Independence With Stakeholder Representation (Part 1 - Current)

- Requirement 2: The Regional Entity has established rules that assure its independence of users, owners, and operators of the bulk-power system while assuring fair stakeholder representation in the selection of its directors
 - ❑ PURA requires that the ERCOT Bylaws and Protocols and fees be approved by the PUC
 - ❑ The current ERCOT Bylaws require:
 - 5 Unaffiliated Directors approved by the PUC;
 - Each market segment (including consumers) annually elects its representative Director and Technical Advisory representative;
 - To transact business, 51% of seated Directors must be present; and
 - A vote of at least 67% of eligible Directors is required for Board to act

Requirement 2 – Independence With Stakeholder Representation (Part 2 - to be added to ERCOT Bylaws)

- Requirement 2: The Regional Entity has established rules that assure its independence of users, owners, and operators of the bulk-power system while assuring fair stakeholder representation in the selection of its directors
 - ❑ ERCOT will modify its Bylaws to establish specific rules to ensure independence of the Texas RE from ERCOT:
 - Texas RE will be a functionally separate division of ERCOT, which will be led by a Chief Compliance Officer (CCO);
 - Texas RE will report to the ERCOT Board administratively only - budget will be approved by the ERO and the performance of the CCO and his team will be reviewed by the PUC and by the ERO (during its 3-year audits) for Reliability Standards enforcement;
 - PUC will provide due process (hearing) for any contested Reliability Standards enforcement actions by the Texas RE
 - PUC will make a recommendation regarding each contested Reliability Standards action (enforcement matters under the Protocols will continue under the current procedures);
 - CCO of the Texas RE will make all final determinations on Reliability Standards enforcement actions and submit these to the ERO, in accordance with the ERO's Rules of Procedure
 - FERC will hear all appeals of Reliability Standards determinations

Requirement 3 – Balanced RE Decision-making

- Requirement 3: The Regional Entity has established rules that assure balanced decision-making in its committees and subordinate organizational structures
 - ❑ The Texas RE will form a Reliability Standards Committee (as described in the Regional Standards slides) to allow balanced decision-making and due process for Reliability Standards modifications
 - ❑ The ERCOT Bylaws will be amended to include the formation of the Reliability Standards Committee

Requirement 4 – Rules Allow Openness and Due Process

- Requirement 4: The Regional Entity has established rules that provide reasonable notice and opportunity for public comment, due process, openness, and balance of interests in exercising its duties
 - ❑ As required by PURA, the ERCOT Bylaws require:
 - All meetings of the ERCOT Board be open to the public
 - ERCOT provide at least 7 days' advance notice (less notice of at least 24 hours for urgent matters) of meetings and the planned agendas of the meetings and an opportunity to comment on matters under discussion at the meetings
 - ❑ Texas RE's Reliability Standards Committee will allow public comment and due process
 - ❑ ERCOT's balanced market and independent Board and its voting requirements also ensure a balance of interests in exercising its duties

Requirement 5 – Prohibit Excess Voting Power

- Requirement 5 - The Regional Entity has established rules that assure that no two industry sectors can control and no one industry sector can veto any action
 - ❑ Because of the ERCOT Board voting requirements (67% with a 51% Quorum requirement,) 2 industry sectors cannot control and no 1 industry sector can veto any action
 - ❑ The Reliability Standards Committee will adopt voting requirements that prohibit any two industry sectors from controlling and no one industry sector from vetoing any action

Regional Standards

Regional Standards Development Process

➤ General Concepts

- ☐ ERCOT-Specific Standards go beyond, add detail to, or implement NERC Reliability Standards
- ☐ Fair and open process
- ☐ Due process to ensure equality, accessibility, and responsiveness
- ☐ Any Entity with a direct and material interest in the bulk power system can participate
- ☐ All Standards shall be consistent with market interface principles
- ☐ Each Standard shall establish technical and performance requirements that can be practically measured

Regional Standards Development Process

➤ Specific Concepts

- ❑ Participation is open to all organizations that are directly and materially affected by the Texas Reliability Entity's (RE) Bulk Power System reliability
- ❑ Any ERCOT Market Participant can submit a Regional Reliability Standard Request to the Texas RE
- ❑ The Texas RE Standards Staff will coordinate and facilitate the process to develop, revise, or delete ERCOT-Specific Reliability Standards
- ❑ A "Reliability Standards Committee" comprised of Market Participants will meet to:
 - Consider which requests for new or revised Reliability Standards shall be assigned for development
 - Vote on proposed new or revised Reliability Standards

Regional Standards Development Process

- Specific Concepts - continued
 - ❑ The “Reliability Standards Committee” will have an open membership structure – fractional voting structure by market segment similar to current PRS
 - ❑ “Standards Drafting Teams” assigned by the ROS – comprised of technical experts, a member of the Texas RE Standards Staff, and the originator of the request
 - ❑ The ERCOT Board of Directors shall act on any proposed ERCOT-Specific Reliability Standard that has gone through the process
 - ❑ Appeals Process available for appealing any negative decision

Compliance Enforcement

Compliance Enforcement Process

➤ General Concepts

- ☐ All Bulk Power System owners, operators, and users are required to comply with all approved NERC and ERCOT-Specific Reliability Standards at all times
- ☐ All Bulk Power System owners, operators, and users shall submit timely and accurate information when requested by the Texas RE or NERC

Compliance Enforcement Process

➤ Specific Concepts

- ❑ Proposed that the Texas RE will be functionally separated from the ERCOT ISO and will report to the ERCOT Board of Directors for administrative purposes
- ❑ Proposed that the Texas RE shall have a staff of up to 22 to directly manage and implement the Texas RE Compliance Enforcement Program (CEP)
- ❑ Proposed that the Texas RE will consist of the following functional areas:
 - Compliance
 - Reliability Standards
 - Legal/Regulatory/Enforcement
 - Corporate Operations

Compliance Enforcement Process

➤ Specific Concepts – continued

- ❑ The Texas RE CEP shall carry out the delegated functions of the NERC CEP by:
 - Monitoring and enforcing compliance with NERC and ERCOT-Specific Reliability Standards and Requirements for all entities within ERCOT, including the ERCOT ISO
 - Reporting all violations of all Reliability Standards, including ERCOT-Specific Standards, to NERC
 - Maintaining processes for data gathering, reporting, investigating, auditing, assessing, penalizing and sanctioning violators, and mitigating non-compliance
 - Performing the compliance and enforcement functions of the NERC CEP by exercising the authority delegated to the Texas RE by NERC in its delegation agreement

Compliance Enforcement Process

➤ Specific Concepts – continued

- ❑ All possible compliance actions for violations of NERC and ERCOT-Specific Standards and ERCOT reliability-based Protocols and Operating Guides requirements will be referred to the Public Utility Commission of Texas (PUCT) for action as follows:
 - ❑ NERC or ERCOT-Specific Standards –
 - The PUCT will review and issue a recommended decision
 - The Texas RE Executive Director will make the final decision with respect to enforcement
 - The issue will be forwarded to the ERO and FERC

Compliance Enforcement Process

➤ Specific Concepts – continued

- ❑ ERCOT reliability-based Protocol or Operating Guide requirement –
 - The PUCT will review and render a final decision
- ❑ In all cases, due process will be provided to any entity that is reported to have violated a standard, in accordance with the requirements developed by FERC or NERC or in accordance with the requirements of State law, as applicable
- ❑ Will use industry experts and Texas RE Members' technical expertise in compliance activities as necessary