

Texas Regional Entity

An Independent Division of ERCOT

Date: September 11, 2007

To: Board of Directors of Texas Regional Entity ("Texas RE"), a division of Electric Reliability Council of Texas, Inc.

From: Larry Grimm, Acting Chief Compliance Officer

Subject: Approval of Resolution Adopting Amended and Restated Delegation Agreement between Texas RE and North American Electric Reliability Corporation for Federal Energy Regulatory Commission Approval

Issue for the Texas Regional Entity Board of Directors

Texas Regional Entity Board of Director Meeting Date: September 18, 2007

Agenda Item No.: 5

Issue:

Approval of certain amendments to the Delegation Agreement between Texas Regional Entity ("Texas RE") – a division of Electric Reliability Council of Texas, Inc. ("ERCOT") and approval of Texas RE staff moving forward with a compliance filing of amendments to the Delegation Agreement between Texas RE and the North American Electric Reliability Corporation ("NERC") for Federal Energy Regulatory Commission ("FERC") approval in accordance with FERC's Order of April 19, 2007 (the "Amended and Restated Delegation Agreement"), with the understanding that the Board of Directors ("Board") must approve all changes NERC or FERC may require prior to Texas RE's execution of the Amended and Restated Delegation Agreement.

Background/History:

Title XII, Subtitle A of the Energy Policy Act of 2005 (EPAc) added section 215 to the Federal Power Act (FPA), mandating enhanced federal oversight of the bulk-power system (essentially, the transmission grid and interconnected generation facilities) throughout the U.S., including in the ERCOT Region. Section 215(c) specifically provides for a new Electric Reliability Organization (ERO) authorized to establish and enforce Reliability Standards for the bulk-power system, subject to FERC oversight. On July 20, 2006, FERC named NERC the ERO.

EPAc authorizes NERC, as the ERO, to delegate authority to Regional Entities (REs) for the purpose of proposing and enforcing federal Reliability Standards and working with the ERO to set regional variances, as needed. ERCOT has formed a functionally separate division (Texas Regional Entity or "Texas RE") that acts as the RE for the ERCOT Region and performs: (1) the new federal statutory RE duties (proposing and enforcing federal Reliability Standards and variances) and (2) ERCOT compliance monitoring and enforcement under the Protocols. The cost of the ERCOT compliance activities under the Protocols could continue to be funded as part of the ERCOT System Administration Fee. The cost of the federal statutory RE duties will be funded by NERC, in accordance with a separate budget created by Texas RE, pursuant to the Delegation Agreement approved by FERC, subject to exceptions. The Texas RE is led by a Chief Compliance Officer, who reports directly to the Board and must be acceptable to the Public Utility Commission of Texas ("PUCT").

NERC and ERCOT negotiated and submitted to FERC a Delegation Agreement to define the interactions of NERC, ERCOT, and Texas RE, including ERCOT's billing and collection of ERO

and RE fees from Load Serving Entities, ERCOT's submission of all such fees to NERC, and NERC's remittance to Texas RE to fund its federal activities under EPAct, pursuant to the Delegation Agreement.

The Board approved the Delegation Agreement submission to FERC at its November 14, 2006 meeting. On November 29, 2006, NERC submitted the Texas RE Delegation Agreement for FERC review. On April 19, 2007, FERC approved the Delegation Agreement, although it also identified areas of concern in the Delegation Agreement, which require modifications. FERC ordered that NERC and Texas RE make a compliance filing within 180 days of the date of the Order (*i.e.* by October 16, 2007).

After FERC issued the Order, Texas RE and NERC pursued discussions to develop language conforming to the Order's terms. The Amended and Restated Delegation Agreement is substantially the same as the version approved by the Board and filed previously, with the principal differences being: (1) modifications to Exhibit D and Attachment 1, designed to refine the set of hearing and related procedures previously approved; (2) the development of a Texas RE/ERCOT-Region-specific hearing procedure incorporating, by reference, substantially all of the Public Utility Commission of Texas's Chapter 22 Procedural Rules; (3) the incorporation of certain modifications to the funding and budgeting processes under NERC's aegis, contained in Exhibit E, and (4) language at the top of Exhibit B, clarifying that, although a copy of the ERCOT bylaws is included as required by NERC, ERCOT requests that FERC adopt as Texas RE rules only the portions of the bylaws that are specifically cited in Exhibit B, and that FERC determine that the remainder of the ERCOT bylaws are not considered Texas RE rules and do not require NERC or FERC approval.

A draft Resolution approving Texas RE staff's pursuit of actions necessary to obtain approval of the Amended and Restated Delegation Agreement (including incorporated Exhibits) is attached as Exhibit A to this Memorandum. The draft Amended and Restated Delegation Agreement, including its exhibits (with the proposed changes to the exhibits accepted) is attached as Exhibit 1 to the draft Resolution.

A redline of the Amended and Restated Delegation Agreement and Exhibits modified to comply with the April 19 Order is attached as Exhibit 2 to this Memorandum.

Key Factors Influencing Issues:

1. With certain exceptions intended to clarify previously adopted language, the amendments to the Delegation Agreement are meant to effect compliance with the FERC's April 19, 2007 Order approving the agreement.
2. The Procedures set forth in Exhibit D and Attachments 1 and 2 have been vetted thoroughly with FERC counsel, NERC, and the PUCT, and their input has been considered and, where appropriate, we have incorporated their suggested changes.
3. The Procedures set forth in Exhibit D and Attachments 1 and 2 were posted on the Texas RE website and a notice to all Registered Entities was emailed on Tuesday, August 28, 2007, requesting comment by the close of business on Tuesday, September 4, 2007. One set of comments was received and, where appropriate, changes were adopted.
4. The changes reflected in Exhibit E pertaining to funding were developed in coordination with NERC and ERCOT-ISO and reflect requirements of the April 19 Order.
5. The new language at the top of Exhibit B is intended to clarify ERCOT's position regarding its bylaws, and is consistent with the May 17, 2007 Petition for Clarification, which was filed with FERC.

Alternatives:

The Amended and Restated Delegation Agreement is a compliance filing, except with respect to the procedures adopted in Exhibit D and its attachments. Accordingly, to meet FERC's requirements, no real alternatives exist. With respect to the procedures, alternatives were discussed, such as using the Texas Rules of Civil Procedure, the Federal Rules of Civil Procedure, or the NERC Rules of Procedure for the conduct of enforcement hearings. However, because the PUCT is the Texas RE's "hearing body," the choice of incorporating the PUCT's own Procedural Rules appears to be the best alternative.

Likewise, Exhibit E, pertaining to Texas RE funding, merely effects FERC's requirements and no feasible alternatives exist.

Conclusion/Recommendation:

Texas RE requests that the Board adopt the Resolution and approve this compliance filing.

**RESOLUTION OF
THE BOARD OF DIRECTORS OF TEXAS REGIONAL ENTITY,
A DIVISION OF ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.**

September 18, 2007

WHEREAS, the Delegation Agreement by and between Texas Regional Entity ("Texas RE"), a division of Electric Reliability Council of Texas, Inc., a Texas nonprofit corporation ("ERCOT"), and North American Electric Reliability Corporation ("NERC") was approved by the Federal Energy Regulatory Commission ("FERC"), subject to certain modifications pursuant to FERC's order of April 19, 2007 ("April 19 Order"); and

WHEREAS, the Texas RE Staff has prepared an Amended and Restated Delegation Agreement, including: (1) conforming modifications to the Delegation Agreement itself; (2) modifications to Exhibit D and Attachment 1 to Exhibit D and the addition of an Attachment 2—Procedural Rules to Exhibit D; (3) modifications to Exhibit E pertaining to funding of the Texas RE; and (4) additional language at the top of Exhibit B clarifying ERCOT's position regarding its bylaws; all such modifications and additions intended to conform the Amended and Restated Delegation Agreement to the requirements of the April 19 Order, in a form attached to this Resolution as Exhibit 1; and

WHEREAS, the Amended and Restated Delegation Agreement has been developed, where required, in conjunction with NERC Staff, FERC Staff, and the Public Utility Commission of Texas ("PUCT") Staff, and with input from Texas RE Responsible Entities;

NOW, THEREFORE, BE IT RESOLVED,

The Texas RE Staff may move forward with a compliance filing of amendments to the Delegation Agreement between Texas RE and the North American Electric Reliability Corporation ("NERC"), for the Federal Energy Regulatory Commission's ("FERC") approval in accordance with FERC's Order of April 19, 2007 (the "Amended and Restated Delegation Agreement"), with the understanding that the Board of Directors ("Board") must approve all changes that NERC or FERC may require prior to Texas RE's execution of the Amended and Restated Delegation Agreement.

CORPORATE SECRETARY'S CERTIFICATE

I, _____,
of Texas Regional Entity ("Texas RE"), a division of Electric Reliability Council of Texas, Inc., a Texas nonprofit corporation ("ERCOT"), do hereby certify that, at the September 18, 2007 ERCOT Board Meeting, the Board of Directors of Texas RE passed a Resolution approving the above resolution.

The Motion passed [describe how: by unanimous voice vote; with four voting against; etc.] by the Board.

IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____, 2007.

Exhibit 1 to Exhibit A
Amended and Restated Delegation Agreement

Exhibit B
Redline of Amended and Restated
Delegation Agreement Against
Approved Delegation Agreement