



Legal Department Report:  
2009 Unaffiliated Director  
Above-Cap Compensation

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**H.R. & Governance Committee Meeting**

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## Issues Addressed.

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- **Background: Compensation of Unaffiliated Directors.**
- **The 2009 payment tracking error and discovery of the error in 2010.**
- **Internal Audit reviews of 2009 Unaffiliated Director compensation and expense reimbursements.**
- **Actions taken to remedy and prevent recurrence of the 2009 above-cap compensation.**
- **Review of ERCOT expense reimbursement policies.**

## Background: Compensation of Unaffiliated Directors.

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### **ERCOT Board Policies & Procedures establish the components of compensation for Unaffiliated Directors.**

(Section 2.8.1)

- Annual Retainer: \$40,000 per Director. Payments made monthly on pro-rated basis.
- Board Chair: \$10,000 in addition to retainer, also paid monthly on a pro-rated basis.
- Per-meeting fees:
  - \$2000 for each day of Board meetings.
  - \$900 for each Board Committee meeting attended (limited to one committee meeting fee per day).
  - Prior to TRE separation in 2010, \$900 per TRE Board meeting; \$400 per TRE committee meeting.
- Limit on total compensation: “[I]n no event shall an Unaffiliated Director’s total compensation exceed \$89,800 per year, except that the cap for an Unaffiliated Director who serves as Board Chair for any part of a year shall not exceed \$99,800 per year.”

## Background: Compensation of Unaffiliated Directors (cont'd).

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- Unaffiliated Directors seeking reimbursement of expenses must comply with the ERCOT Business Expense Reimbursement Corporate Standard. The same Corporate Standard applies to reimbursement of ERCOT employee expenses.
- ERCOT's General Counsel is to provide Directors a copy of the ERCOT Business Expense Reimbursement Corporate Standard, as well as with copies of any changes to the Corporate Standard.
- The ERCOT Business Expense Reimbursement Corporate Standard is reviewed by management annually. The Corporate Standard is currently under review, and is expected to be revised for 2011.

## The 2009 payment tracking error and discovery of the error in 2010.

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- In 2009, the payment of Unaffiliated Director retainers, per-meeting fees, and expense reimbursements were processed by the Legal and Finance departments. All payments made to Unaffiliated Directors were checked against documentation including:
  - Corporate minutes recording Unaffiliated Directors' attendance at particular Board and/or Committee meetings.
  - Reports submitted by Unaffiliated Directors documenting their attendance at Board and/or Committee meetings.
  - Expense reports submitted by Unaffiliated Directors.
- The Board held an unusually large number of meetings in 2009. All payments to Unaffiliated Directors were for Board or Committee meetings actually attended, but the aggregate compensation paid to each Director exceeded the approved caps.
- Each of the five Unaffiliated Directors serving in 2009 received above-cap compensation. The amounts of above-cap compensation were directly related to the number of Board and Committee meetings each Director attended.
- The total of 2009 above-cap compensation paid to all five Unaffiliated Directors was \$31,199.80.

## The 2009 payment tracking error and discovery of the error in 2010 (cont'd).

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- Internal investigations indicate that the error was caused by a failure to track per-meeting payments to Unaffiliated Directors against the compensation caps, due to inadequate processes and communications regarding:
  - Internal ownership of controls necessary to enforce the cap.
  - Application of the cap to TRE meetings.
  - Preparation of information informing Unaffiliated Directors of the amount of payments received measured against the compensation cap.
- The error was discovered in late April 2010 by the Legal Department. Independent of the Legal Department, the error was also discovered as part of Internal Audit's quarterly testing of fraud-related corporate controls. Internal Audit worked with the Legal Department on the issue, and reported its findings in June 2010.
- Internal Audit's report was sent to the Finance & Audit Committee and the Public Utility Commission of Texas on June 23, 2010.
- The erroneous payments were reported to the Board's Finance & Audit Committee at July 2010 meeting, and the Human Resources & Governance (HR&G) Committee and full Board of Directors in August 2010. (The issue was scheduled for a report at the June 2010 HR&G meeting, but was deferred due to the numerous other issues facing that committee that month.)

Internal Audit reviews of 2009 Unaffiliated Director compensation and expense reimbursements.

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## Compensation

- As part of its first quarter 2010 Fraud Auditing Program review, Internal Audit found payments to 2009 Unaffiliated Directors in excess of the compensation caps.
- Internal Audit determined that the 2009 above-cap compensation was paid not as the result of fraudulent activities, but for meetings actually attended by the affected Directors.
- The Legal Department accepted responsibility for creating a process to remedy the failure to track payments against the compensation cap.

## Internal Audit reviews of 2009 Unaffiliated Director compensation and expense reimbursements.

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### Expense Reimbursements

- At the August 2010 ERCOT Board meeting, Public Utility Commission Chairman Barry T. Smitherman requested Internal Audit conduct an audit of 2009 expense reimbursements to the five Unaffiliated Directors in 2009.
- Internal Audit reviewed 2009 reimbursed expenses for airfare, mileage, meals, hotels, auto rentals, and miscellaneous expenses submitted by Unaffiliated Directors, totaling \$43,342.
- Internal Audit concluded that the 2009 expense reimbursements were valid and appropriate according to the guidelines in the Board Policies & Procedures and the ERCOT Business Expense Reimbursement Corporate Standard.



## Actions taken to remedy and prevent recurrence of the 2009 above-cap compensation.

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- Repayment of above-cap compensation by 2009 Unaffiliated Directors. Repayment for Unaffiliated Directors serving terms through end of 2010 was accomplished by netting the 2009 above-cap compensation against 2010 compensation.
- Communication regarding when cap will be reached for 2010 Unaffiliated Directors.
- Legal and Finance Department review of failure to track compensation against caps – immediate incorporation of “lessons learned” into new process for handling Unaffiliated Director compensation.
- Transfer ownership of process to Finance, with payment approvals by the Chief Executive Officer. Legal Department to assist with documenting attendance at Board meetings from corporate minutes, but will not be responsible for tracking or approving invoices or payments.
- Improved communications with Unaffiliated Directors regarding the status of year-to-date compensation against the cap.
- Consideration of compensation cap impact in Board meeting planning for future years.

## Review of ERCOT expense reimbursement policies.

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- Internal Audit of Unaffiliated Director expense reimbursements confirmed that the expense approval process is working as intended.
- Review of the audit raised questions about certain aspects of the ERCOT Business Expense Reimbursement Corporate Standard:
  - Standard for hotel expenses.
  - Per diem policies.
  - Travel expense considerations.
- The Corporate Standard is currently under review, and ERCOT management expects changes will be included that address concerns identified in review of the audit.

## Conclusion

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- ERCOT management regrets that the failure to adequately track Unaffiliated Director payments to the Board-approved compensation cap:
  - Resulted in above-cap compensation being paid.
  - Was caused by inadequate controls affecting a Board-approved policy determination.
  - Created negative perceptions of ERCOT's stewardship of its finances.
  - Resulted in inconvenience for the affected Directors and distraction from the pressing issues facing the entire Board.
- Management is confident that the new procedures put in place to remedy the failure to properly monitor payments in 2009 will prevent the issue from recurring in the future.