Date: March 14, 2011
To: Human Resources and Governance (HR&G) Committee
From: Bill Magness, Vice President and General Counsel
Subject: Item 5 – Report on Adoption of Public Utility Commission of Texas (PUCT) Rule on ERCOT Oversight

At its February 24, 2011 Open Meeting, the PUCT adopted amendments to its rules regarding ERCOT accountability, performance, and governance. The rules become effective on March 22, 2011. The new rules affect numerous issues related to ERCOT governance, budget planning, and regulatory reporting. A copy of the Commission's Order adopting the rules is attached to this memorandum for ease of reference.

The new rules impact ERCOT activities overseen by both the HR&G and Finance and Audit (F&A) Committees. ERCOT Legal makes this presentation to the HR&G Committee because the issues regarding implementation of the new rules are more time-sensitive in the governance arena. Staff welcomes input and questions from all Board members as we consider ERCOT's implementation actions.

I prepared the following memorandum that highlights the portions of the new rules that may require changes in ERCOT Bylaws, Board Policies and Procedures, Committee Charters, or other governance documents. ERCOT Legal is not recommending that all these changes be made immediately, but that the HR&G Committee and Board consider them as part of ERCOT's effort to implement the Commission's rules.

Notably, if there are conflicts between the Commission's rules and ERCOT's governance documents, the Commission's rule prevails. Therefore, as long as ERCOT's actions do not violate the Commission's rules, the existence of inconsistent provisions in governance documents should not create a compliance issue. Corporate best practices, however, counsel revising governance documents to create consistency with the applicable legal requirements.

I look forward to discussing these matters with the HR&G Committee at its March 21, 2011 meeting.

ERCOT "Action Items" Related to Revisions to
P.U.C. SUBST. R. §§ 25.361 – 25.363

§ 25.362 Electric Reliability Council of Texas (ERCOT) Governance

Commission Mandated Audits

(c)(3) " … Commission-mandated audits, as contemplated in PURA § 39.151(d) and (d-1), shall be funded by ERCOT and do not require approval by the governing board of ERCOT."

- Audit of nodal program moving forward based on contract between Navigant, PUCT, ERCOT (effective date March 7, 2011).
- Consider revising ERCOT Board Policies and Procedures 2.4.4 and 2.4.5 (requiring Board approval of "purchase of goods and services" with a value of over $1,000,000 if within approved budget, or over $3,000,000 whether in or beyond budget).

Standards for Removal from ERCOT Board

(g)(2) & (3): [standards for removal include violation of] an ERCOT rule, including a written ERCOT policy adopted under this section, or commission rule, or applicable statute.

- Consider revising ERCOT Bylaws § 4.5 (Vacancies and Removal) and 9.3 (Prohibited Acts), and Board Policies and Procedures § 7 (Procedures for Selection of New Board and TAC members).

Unaffiliated Directors

(g)(5) ERCOT shall notify the commissioners when a vacancy occurs for an unaffiliated member of the governing board. ERCOT shall provide information to the commissioners concerning the process for selecting a new member, the candidates who have been identified and their qualifications, any recommendation that will be made to the governing board, and any other information requested by a commissioner. The selection of an unaffiliated member of the governing board is subject to approval by the commission. A person who is selected may not serve as a member of the governing board until the commission approves the selection. An unaffiliated board member whose three-year term has expired shall, if reappointed by the ERCOT governing board, cease serving as a member of the governing board until the reappointment is approved by the commission. The commission may remove an unaffiliated member of the governing board without cause. Compensation, per diem and travel reimbursements to be paid to unaffiliated members of the governing board shall be subject to commission review and approval.

- On March 22, 2011, the ERCOT Board will convene its Nominating Committee to discuss upcoming vacancies – June 2011 initial term expiration; November 2011 vacancy.

- Consider revising ERCOT Bylaws § 4.3(b) (Selection of Unaffiliated Directors) and 4.3(c) (Terms of Unaffiliated Directors) and Board Policies and Procedures § 7.3 regarding selection and seating of unaffiliated directors.
- Revisit timing of process for executive search and identification of unaffiliated director candidates based on requirement of Commission approval before directors serve, to ensure continuity when vacancies occur.
- Consider revising ERCOT Bylaws § 4.5 (Vacancies and Removal of Directors).
- Consider revising ERCOT Board Policies and Procedures § 2.6 (Duties of Directors).
- Unaffiliated Directors' compensation and expense reimbursement are addressed in Board Policies and Procedures § 2.8 and in the ERCOT Business Expense Reimbursement Corporate Standard.

Participation in ERCOT Activities by Former Board Members

(g)(6) A member of the governing board of ERCOT appointed after the effective date of this paragraph who serves as an unaffiliated member may not represent a market participant before the governing board of ERCOT, the ERCOT technical advisory committee, or any of its subcommittees or working groups, for a period of one year after the person ceases to serve as a member of the governing board.

- Consider revising ERCOT Bylaws § 4.3 (Selection, Tenure and Requirements of Directors and Segment Alternates).

Chief Executive Officer (CEO)

(h) Chief executive officer. The appointment of the chief executive officer of ERCOT is subject to commission approval. ERCOT shall notify the commissioners when a vacancy occurs for the chief executive officer. ERCOT shall provide information to the commissioners concerning the process for selecting a new chief executive officer, the candidates who have been identified and their qualifications, any recommendation that will be made to the governing board, and any other information requested by a commissioner. A person may not seek the position of the ERCOT chief executive officer while serving as a commissioner. Compensation to be paid to the ERCOT chief executive officer shall be subject to commission review and approval.

- Consider revising ERCOT Bylaws § 4.10 (Duties of Board), where "approval of the employment and terms of the CEO, as well as termination of CEO's employment" are non-delegable duties of the Board.
- Review Nominating Committee process regarding information provided to Commission when CEO vacancy occurs.
- Consider revising Bylaws § 7.1 regarding service by sitting Commissioner.

ERCOT Annual Report

- Revised schedule detailed in § 25.362(i). The "annual report" items are due "not later than 120 days after the end of the year." Report due April 30, 2011.

- ERCOT staff reviewing additional items due in the annual report to ensure new required information included (e.g., "derivative transaction" information required by subsection (i)(1)(C)(iv)).

ERCOT Operations Report and Plan

- First version of report due on January 15, 2012, but ERCOT staff now working to develop items required in the report.
- Additions to report identified at 25.362(i)(F)-(I):
  (F) Risk management plan
  (G) Emergency communications plan
  (H) Reliability and adequacy of ERCOT system during extremely hot or cold weather
  (I) Identification of transmission constraints

Meeting Periodicity Report

(i)(5) Meeting Periodicity Report. Beginning with the effective date of this section, ERCOT shall recommend annually to the commission the periodicity of governing board meetings. ERCOT's recommendation shall be based on an examination of the frequency of meetings conducted by similar organizations and shall include an estimate of the costs associated with meeting more frequently than once per quarter.

- ERCOT Bylaws § 4.6 provides that the Board shall meet "at least quarterly," so move to quarterly meetings would not require Bylaws changes.
- ERCOT staff examining per-meeting costs and practices of other ISO/RTOs, and will present information to ERCOT Board and HR&G Committee.

§ 25.363 ERCOT Budget and Fees

ERCOT Debt

(a)(4) ERCOT shall not incur debt or defer scheduled principal repayments of debt without commission approval. ERCOT shall seek approval of any loan or agreement to provide a line of credit from a bank or other institution, the issuance of bonds or notes, and any arrangements that would permit it to issue bonds or permit the issuance of bonds on its behalf at a later date. This paragraph does not require approval of a contract to lease equipment or other property used in normal operations or approval of a loan or draw on an existing line of credit or other credit arrangement that has been approved by the commission.

- ERCOT will incorporate debt approval into process for reviewing proposed additional debt or changes in principal repayments.
- ERCOT expects any change in debt would be addressed in discussion of overall budget.

Budget Review and Approval

(d) Commission review and action. The ERCOT annual budget and any change in the system administration fee are subject to review by the commission. Prior to the submission of a proposed budget or change in the system administration fee to the governing board for its approval, ERCOT shall consult with commission staff designated by the executive director in connection with the development of the budget and shall provide to the staff information concerning budget strategies, staffing requirements, categories of expenses, capital outlays, exceptional expenses and capital items, and proposals to incur additional debt. ERCOT shall file with the commission its board-approved budget, budget strategies, and staffing needs, with a justification for all expenses, capital outlays, additional debt, and staffing requirements. The commission may approve, reject or modify the budget and budget strategies.

- ERCOT staff is developing the 2012 budget, and will schedule meetings with Commission staff similar to process used for development and review of the 2011 ERCOT budget.
- Revisions may be necessary to the F&A Committee Charter to memorialize the budget process. ERCOT may also consider revision to clarify Bylaws § 10.3 regarding budget approval.

ERCOT User Fees

(f) User Fees. ERCOT may charge reasonable user fees for services provided by ERCOT to any market participant or other entity. User fees do not include the system administration fee and the ERCOT nodal implementation surcharge. A new or revised user fee may be approved by the ERCOT governing board, without the filing of an application under §22.252 of this title (relating to Approval of ERCOT Fees and Rates). Any affected entity, including the commission staff and the public counsel, may file an appeal of the establishment or revision of a user fee, in accordance with § 22.251 of this title (relating to Review of Electric Reliability Council of Texas (ERCOT) Conduct), except that the provisions of § 22.251(c) of this title (which requires the use of Section 20 of the ERCOT Protocols (Alternative Dispute Resolution Procedures), or Section 21 of the Protocols (Process for Protocol Revision), or other Applicable ERCOT Procedures) shall not apply.

- ERCOT staff reviewing possible areas for additional user fees to incorporate into 2012 budget and fee package.
- ERCOT staff is developing a request for the ERCOT Board to approve increase in the Security Screening Study fees currently included in the ERCOT Fee Schedule.