



Ethical Responsibilities of ERCOT Board Service

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Summary

- **Objective**
- **Corporate and Tax Status of ERCOT**
- **Review of Key Provisions of ERCOT Governing and Corporate Documents**
- **Statutory Authority**
- **Fiduciary Duties**
- **Key Points of Antitrust Law**

Objective

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To provide Directors and Segment Alternates with training on their ethical responsibilities associated with their service on the ERCOT Board of Directors.

As a reminder, Segment Alternates may:

- Attend meetings in the absence of the Director for the same Segment; and
- Vote on the absent Director's behalf in the event that the Director cannot attend a Board meeting.

Corporate and Tax Status of ERCOT

Brief History – Corporate and Tax Status of ERCOT

- **Organized as an unincorporated organization in July 1970**
 - Granted Section 501(c)(6) tax-exempt status by the Internal Revenue Service (IRS) as an unincorporated association in April 1972
- **Incorporated as a Texas non-profit corporation in October 1990**
 - Granted Section 501(c)(6) tax-exempt status by the IRS as a Texas non-profit corporation in June 1991
 - Certified by the Public Utility Commission of Texas (Commission) as the independent organization for the ERCOT Region in April 2000
 - Granted Section 501(c)(4) tax-exempt status by the IRS, retroactive to April 2000, as a Texas non-profit corporation in April 2008

What is ERCOT as an organization today?

- **A Texas non-profit corporation**
 - With members and
 - Without capital stock
- **A Section 501(c)(4) tax-exempt organization – specifically, a social welfare organization**
 - Operates exclusively for the promotion of social welfare
 - Promotes the common good and general welfare of the community
 - Lessens the burdens of government

Current Corporate and Tax Status

In brief, ERCOT promotes the common good and general welfare of the community as a whole by reliably operating the electric grid and administering relevant markets to facilitate efficient pricing and resource adequacy.

ERCOT lessens the burdens of government by performing the following four functions of an independent organization required by the Texas Legislature pursuant to the Public Utility Regulatory Act (PURA) Section 39.151(a):

- (1) Ensuring access to the transmission and distribution systems for all buyers and sellers of electricity on non-discriminatory terms;
- (2) Ensuring the reliability and adequacy of the regional electrical network;
- (3) Ensuring that information relating to a customer's choice of a retail electric provider is conveyed in a timely manner to the persons who need that information; and
- (4) Ensuring that electricity production and delivery are accurately accounted for among the generators and wholesale buyers and sellers in the region.

In April 2000, the Commission certified ERCOT as an independent organization to perform the functions required by PURA.

PURA Section 39.151(b) defines “independent organization” as:

An independent system operator or other person that is sufficiently independent of any producer or seller of electricity that its decisions will not be unduly influenced by any producer or seller.

Review of Key Provisions of ERCOT Governing and Corporate Documents

ERCOT Amended and Restated
Articles of Incorporation
(filed on January 4, 2001)

ERCOT Amended and Restated Articles of Incorporation

Brief Summary of ERCOT's Current Articles

- **One – Name**
- **Two – Non-Profit Corporation**
- **Three – Duration**
- **Four – Purpose**
- **Five – Registered Office and Agent**
- **Six – Current Board Members**
- **Seven – Powers**
- **Eight – Restrictions and Requirements**
- **Nine – Members**
- **Ten – Managing Body**
- **Eleven – Action Without a Meeting**
- **Twelve – Limitation of Liability of Directors**
- **Thirteen – Construction**

Purpose – Article 4

Limited corporate purpose includes:

- Promoting the reliable and efficient operations of electric power systems;
- Ensuring open access for all users of the ERCOT transmission and distribution systems on a non-discriminatory basis;
- Coordinating activities within the region of the Electric Reliability Council of Texas and as liaison to the North American Electric Reliability Council (which was relevant when Texas Regional Entity was an independent division of ERCOT); and
- Performing the functions of an Independent Organization.

Limitation of Liability of Directors – Article 12

No Director liability for any act or omission, except for:

- A breach of a director's duty of loyalty to ERCOT and/or its Members;
- An act or omission not in good faith or that involves intentional misconduct or a knowing violation of the law;
- A transaction from which a director received an improper benefit, whether or not the benefit resulted from an action taken within the scope of the director's office; or
- An act or omission for which the liability of a director is expressly provided by statute.

Texas Non-Profit Corporation Act: No liability if acting in good faith, with ordinary care, and in a manner reasonably believed to be in ERCOT's best interest.

ERCOT Amended and Restated Bylaws (approved on April 16, 2010)

Independence of Unaffiliated Directors – Section 4.3(b)(2)(ii)

Unaffiliated Directors of ERCOT are required to maintain independence of any Market Participant in the ERCOT Region.

This requirement applies at all times during an Unaffiliated Director's service on the Board.

Independence of Unaffiliated Directors – Section 4.3(b)(2)(ii)

Restrictions applicable to **Unaffiliated Directors** and their **household and family members** (that is, any spouse, parent, parent's spouse, child or sibling, including step and adoptive relatives), include:

- No current or recent (within last two years) ties as:
 - A director or officer of a Market Participant or its Affiliates
 - An employee of an ERCOT Member or North American Electric Reliability Corporation-Registered Entity operating in the ERCOT Region
- No direct business relationships with a Market Participant or its Affiliates
 - Retail customer relationships are allowable
- No ownership of Market Participant stocks or bonds
 - Unless placed in a blind trust prior to seating on Board
- No relationship “that would interfere with the exercise of independent judgment in carrying out the responsibilities of an ERCOT Board member,” including the Delegated Authority pursuant to the Bylaws.

Potential Conflicts of Interest – Section 9.2

- **Actual or potential conflicts of interest of the Director or his/her employer**
 - Affirmative duty to disclose to the Board
 - Where they directly or indirectly affect any matter before the Board
- **Direct interest in a matter of the Director, his/her employer, or a person in whom the Director has a substantial financial interest**
 - Must recuse himself/herself from deliberations and actions on the matter
 - Must abstain from any vote and not otherwise participate in a decision on the matter
 - Any disclosure of a direct interest must be noted in the meeting minutes
 - Identical language to the above-three requirements appears in PURA § 39.1512
 - An interest that is common to the Director's Market Segment, or a general interest of some or all Market Participant Directors, is not a direct interest
- **Loans**
 - ERCOT prohibited from making loans to Directors
 - Disclosure rules apply for any loans from Directors to ERCOT

Prohibited Acts – Section 9.3

Thou Shalt Not:

- Violate the Articles of Incorporation or the Bylaws
- Violate a binding obligation of ERCOT without Board permission
- Act with intent to harm ERCOT or its operations
- Improperly benefit from the operation of ERCOT
- Misuse ERCOT's assets, directly or indirectly
- Wrongfully transfer or dispose of ERCOT property
- Misuse ERCOT's name or any trademark or trade name adopted by ERCOT
- Wrongfully disclose ERCOT's or a Member's confidential information
- Without reasonable written notice to the Members, cause ERCOT or a Member to become FERC-jurisdictional

Any violation of these prohibited acts may lead to sanction, suspension, expulsion or termination after a hearing with the process described in Article 3 of the Bylaws.

Ethics Agreement for Directors and Segment Alternates (revised on March 14, 2011)

Ethics Agreement for Directors and Segment Alternates

- Includes ethical duties contained in the Articles of Incorporation and Bylaws
- Must be signed annually
- Requires full disclosure of an officer or director relationship or owner (or beneficial-interest holder) of more than 10% of the stock with a bank or financial institution that would otherwise be a Qualified Institution as defined in ERCOT's Investment Corporate Standard
- Each Director must disclose all personal relationships with ERCOT vendors to the Board. Such relationships include:
 - Current ties (within last two years) as a director, officer, or employee of an ERCOT vendor
 - Direct business relationships, other than retail, with an ERCOT vendor
 - Directly or indirectly owning or holding at least 5% of voting securities of an ERCOT vendor

Statutory Authority

Public Utility Regulatory Act (effective as of **September 1, 2011**)

PURA Section 39.151 – Essential Organizations

ERCOT is certified as an independent organization by the Commission for purposes of PURA.

PURA Section 39.151 provides, in part, for the following:

- **Functions of an independent organization**
 - Section 39.151(a)
- **Definition of an independent organization**
 - Section 39.151(b)
- **The Commission's certification of an independent organization**
 - Section 39.151(c)
- **The Commission's authority relating to:**
 - Adoption and enforcement of rules relating to the reliability of the regional electrical network
 - Oversight and decertification of the independent organization
 - Sections 39.151(d) and (d-1)

PURA Section 39.151 – Essential Organizations – Cont'd

- **The Commission's authority relating to rates related to the independent organization's costs**
 - Section 39.151 (e)
- **The composition of an independent organization's governing body to maintain certification as an independent organization, including provisions related to selection of unaffiliated directors and requirements of the governing body chair**
 - Sections 39.151(g) and (g-1)
- **The timing of a Sunset review of the Commission and an independent organization**
 - Sections 39.151(n) and (n-1)

PURA Section 39.1511 – Public Meetings of the Governing Body of an Independent Organization

- **Meetings must be open to public attendance and commentary**
 - Including seven days notice of meeting and agenda
 - Shorter notice allowed for “urgent” matters (with subsequent required ratification of actions taken at such meetings)
- **Executive Session is permissible for “sensitive matters” such as:**
 - Confidential Personnel Information
 - Contracts
 - Lawsuits
 - Competitively Sensitive Information
 - Grid-Security Information
- **Bylaws Section 4.6(e) adds further examples of “sensitive matters”:**
 - Deliberation of Purchase of Real Property
 - Receipt of Legal Advice
 - Deployment or implementation of security devices
- **Live webcasting of all public meetings must be provided to the public at no charge**

The provisions of PURA Section 39.1512 are contained in the Bylaws (including Section 9.2), which relate to:

- **Required disclosure of a direct or substantial financial interest of Director or his or her employer before the governing body of an independent organization and recusal on a vote on such matter**
 - Section 39.1512(a)
- **Such disclosure must be recorded in the meeting minutes**
 - Section 39.1512(b)
- **An abstention in this circumstance does not affect the existence of a quorum**
 - Section 39.1512(c)

Fiduciary Duties of Directors

Fiduciary Duties of Directors – General

Texas Non-Profit Corporation Act

- A director shall discharge the director's duties, including duties as a committee member, in good faith, with ordinary care, and in a manner the director reasonably believes to be in the best interest of the corporation.

- A director is not liable for actions taken or not taken as a director if the director acted:
 - In good faith;
 - With ordinary care; and
 - In a manner reasonably believed to be in the best interest of the corporation.

Texas Business Organizations Code Section 22.221

Fiduciary Duties of Directors – General

Under Texas law, three broad duties stem from the fiduciary status of corporate directors, namely the duties of:

- Obedience;
- Loyalty (good faith);
- Due Care (including the business judgment rule).

Gearhart Industries, Inc. v. Smith International, Inc., 741 F.2d 707,719
(5th Cir. 1984)

Duty of Obedience

Under Texas law, the duty of obedience requires a director to avoid committing *ultra vires* acts, *i.e.*, acts beyond the scope of the authority of the corporation as defined by its articles of incorporation or the laws of the state of incorporation.

In Texas, an *ultra vires* act may be voidable. Directors will likely not be held personally liable for any *ultra vires* acts unless such acts are:

- In violation of a specific statute; or
- Against public policy.

With regard to *ultra vires* acts of corporate agents, Texas courts have been reluctant to impose personal liability on directors for illegal or *ultra vires* acts of corporate agents unless the directors either participated in the act or had actual knowledge of the act.

- *Resolution Trust Corporation v. Norris*, 830 F.Supp. 351, 355 (S.D. Tex. 1993).

Duty of Obedience

How can an ERCOT Director fulfill his or her duty of obedience?

- Maintain familiarity with ERCOT's corporate purpose and ERCOT's governing documents
- Dedicate ERCOT's resources to compliance with ERCOT's corporate purpose, mission and authorized activities
- Comply with all applicable laws, policies and procedures
- Avoid *ultra vires* or illegal acts

In your role as a Director: when in doubt, check with an ERCOT attorney.

Duty of Loyalty (Good Faith)

Under Texas law, the duty of loyalty dictates that a director:

- Must act in good faith; and
- Must not allow his personal interests to prevail over the interests of the corporation.

Good faith conduct requires a showing that a director acted with an intent to confer a benefit to the corporation.

- *International Bankers Life Insurance Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1967)

An absence of good faith may be found when a board “abdicates [its] responsibilities and fails to exercise any judgment.”

- *Federal Deposit Insurance Corporation v. Harrington*, 844 F.Supp. 300, 306 (N.D. Tex. 1994)

Duty of Loyalty (Good Faith)

How can an ERCOT Director fulfill his or her duty of loyalty?

- Always be mindful and act in the best interest of ERCOT (the corporation)
- Do not allow personal interests to prevail over the interests of ERCOT (the corporation)
 - Avoid situations of self dealing (that is, deriving a personal profit or advantage at the expense of the corporation)
 - Disclose any potential conflicts of interest to the Board
 - Follow ERCOT's policies regarding conflicts of interest
- Remain diligent in the exercise of judgment in matters brought before the Board

In your role as a Director: when in doubt, check with an ERCOT attorney.

Duty of Care (including the Business Judgment Rule)

Under Texas law, the duty of care requires the director to handle his or her corporate duties with such care as an ordinarily prudent person would use under similar circumstances.

In order to satisfy this obligation, a director must:

- Be diligent and informed; and
- Exercise honest and unbiased business judgment in pursuit of corporate interests.
 - *Gearhart*, 741 F.2d at 719; *McCollum v. Dollar*, 213 S.W. 249 (Tex. Comm'n App. 1919, holding approved).

The business judgment rule is a defense to the duty of care. In Texas, absent a showing of fraud or an *ultra vires* act, Texas courts will not likely interfere with the business judgment of directors.

Duty of Care (including the Business Judgment Rule)

How can an ERCOT Director fulfill his or her duty of care?

- Remain diligent and informed about ERCOT's operations and business activities
- Actively participate in the Board and Committee meetings, including strategic planning and risk assessment
- Review Board and Committee meeting materials prior to the meetings
- If you need additional information or clarification, timely ask an ERCOT staff member for it
- Review minutes for accuracy
- Exercise honest and unbiased business judgment in pursuit of ERCOT's corporate interests

In your role as a Director: when in doubt, check with an ERCOT attorney.

Key Points of Antitrust Law

Antitrust Law – High-Level Summary

Don't:

- Give competitively sensitive information to competitors
- Discuss intentionally disadvantaging competitors
- Discuss shutting out suppliers, competitors, or customers
- Discuss agreements to allocate customers, markets, or geographic areas among competitors
 - Exception: If done pursuant to a law, rule, or Protocol

Do:

- Discuss reliability, market design, grid operations, system planning, market operations, Protocols, Revision Requests and regulatory concerns
- Consider changes that promote reliability and market improvements, even if there will be certain Market Participants who may be disadvantaged
 - **But** disadvantaging certain Market Participants must not be the intent

In your role as a Director: when in doubt, check with an ERCOT attorney.

Questions?