



Date: April 1, 2014
To: ERCOT Board of Directors
From: Bill Magness, Vice President, General Counsel and Corporate Secretary
Subject: Proposed Revisions to CS5.18 Conflict of Interest Corporate Standard

Issue for the ERCOT Board of Directors

ERCOT Board of Directors Meeting Date: April 8, 2014

Agenda Item No.: 11.2

Issue:

Whether the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) should approve revisions to the Conflicts of Interest Corporate Standard (CS5.18 or Standard), to be effective upon Board approval, that would:

- Update ERCOT's policy on investments by ERCOT employees in the securities of Market Participants to be consistent with changes approved for other Independent System Operators / Regional Transmission Organizations (ISO/RTOs);
- Revise the existing guidelines for receipt of goods and services by ERCOT employees from Market Participants and vendors utilized by ERCOT (Vendors); and
- Improve the clarity, effectiveness, and administrative efficiency of CS5.18 generally.

Background/History:

The Human Resources and Governance (HR&G) Committee is expected to consider these proposed revisions to the Standard at its April 7, 2014 meeting and to make recommendations to the Board on this matter.

Strong controls to prevent conflicts of interest are central to ERCOT and all other ISO/RTOs. As neutral operators of electric grids and competitive markets, it is essential that ISO/RTOs prevent real and govern apparent conflicts of interest for all employees. Along with the ERCOT Code of Conduct and Employee Ethics Agreement (which the Committee and Board reviewed and updated in 2013), the standards in CS5.18 provide the foundation for ERCOT's ability to ensure its employees remain independent and objective as they carry out their duties under the Protocols and other legal standards.

The changes proposed in CS5.18 fall into three categories.

1. Ownership in securities of Market Participants.

As part of the effort to address real or apparent conflicts of interest, ERCOT and the other ISO/RTOs have historically had blanket prohibitions on the ownership of the stock or other securities of Market Participants. In recent years, ISO/RTOs have seen an increased presence of "non-traditional" Market Participants. For example, the engagement of financial institutions as powers marketers, or manufacturing or retail businesses as Resource entities or Qualified Scheduling Entities, has resulted in companies being defined as ERCOT Market Participants even though the electric business plays a small overall role in the company's activities.

This development has resulted in rules that prevent employees from investing in stocks that, for all practical purposes, pose negligible risk of conflict with an employee's work at ERCOT. While an over-inclusive standard may prevent all conceivable conflicts, it also makes ERCOT less attractive as an employer (for potential employees who may hold stocks that would have to be divested for no meaningful purpose), and it undermines compliance with ethical standards that do have important practical purposes.

In December 2013, the Federal Energy Regulatory Commission (FERC) approved a proposal from the New York ISO to revise the securities ownership prohibition. *See* FERC Docket No. ER-13-308-000, *Order Accepting Tariff Filings (NYISO)* (Dec. 30, 2013). The approach approved by FERC continues to prohibit ownership of the securities of Market Participants whose primary activity is in the electric markets in ERCOT. For Market Participants outside the electric industry, the FERC-approved test requires that, to be an eligible investment, the company involved (and its affiliates): (a) may obtain no more than 0.5% of its annual gross revenues from purchases and sales in the ERCOT market; and (b) may account for no more than 3% of the purchases and sales in ERCOT in the previous year.

The test makes certain that the Market Participant at issue is engaged primarily in lines of business other than the electric markets in ERCOT, and that its activities in ERCOT do not have a material impact on the overall market. ERCOT Legal believes that the test approved by FERC (while rather complicated to administer) provides a productive alternative to the prohibition on all ownership of Market Participant stock now included in CS5.18. Moreover, as the other ISO/RTOs implement the new standard, ERCOT Legal urges that we keep ERCOT's rule consistent with that applied by its counterparts. If the Board approves the proposed revision to CS5.18, ERCOT Legal will monitor its impact, and report back to the Board on whether implementation of the new standard creates negative unintended consequences.

2. Receipt of goods and services by ERCOT employees.

Currently, CS5.18 authorizes each ERCOT employee to receive up to \$100 in goods or services from Market Participants or Vendors each calendar year (\$100 total from any and all Market Participants and Vendors, not \$100 from each one). To enforce this standard, CS5.18 requires all employees to keep a record of any goods or services received, and the records kept by employees are subject to audit as part of the annual internal audit of compliance with ethics standards.

As a general matter, ERCOT employees avoid taking gifts or allowing Market Participants or Vendors to pay for services (like meals) in order to avoid exceeding the \$100 limit. Nevertheless, compliance with the standard is challenging for several reasons. For example, if a Market Participant or Vendor sends a group in the company a holiday gift basket including food items, how should each employee value his or her portion of that gift? If a group of Market Participants agree to provide a working lunch during an ERCOT Committee meeting, exactly how should the value of the collective meal be calculated – or should the ERCOT employee find the Market Participants who paid for the meal and give them each a portion of the cost of a sandwich and chips?

As these examples epitomize, the current standard does little to prevent harmful conflicts, but does cause unnecessary and time-consuming administrative burdens that, in most cases, are simply getting in the way of conducting normal and appropriate business functions at ERCOT.

The revised CS5.18 proposes replacing the current standard with the following:

- ERCOT employees may not accept gifts from Market Participants or Vendors. ERCOT will inform Market Participants and Vendors of this policy, and that gifts will be returned if sent to ERCOT employees, individually or collectively for a team or department.
- Non-cash nominal gifts and meals customarily provided in the normal course of business (*e.g.*, a key chain with a vendor logo on it; a bagel offered at a conference sponsored by a Market Participant) would not be considered as posing conflicts of interest, and may be accepted by employees without reporting such items.
- In the case of meals or other expenses totaling approximately \$30.00 or less, employees will be allowed to accept them without reporting such items if the item would have been eligible for reimbursement by ERCOT if the employee submitted an expense report for it.
- For larger expenses – *e.g.*, if an ERCOT expert is asked to speak at a conference sponsored by a Market Participant or Vendor in exchange for payment of the travel and lodging expenses associated with attending – the employee should consult with his or her management and document approval by his or her director before accepting the expense reimbursement from the Market Participant or Vendor.

ERCOT Legal has discussed this proposal with ERCOT management and employees, with ERCOT's Internal Audit staff, and with our regulators, and we are convinced that the new approach provides better protection against meaningful conflicts without inhibiting business activity that is both productive for ERCOT and ethically sound.

3. Improving the clarity of the conflict of interest standard.

ERCOT Legal did not provide a redline of the recommended revisions to CS5.18 against the current standard, because the revisions include an overall re-organization and clarification of the text – even of those provisions where no changes are recommended.

Like the Code of Conduct and Ethics Agreement, this Standard is most effective when it is most broadly understood. The re-write offered attempts to state the issues and guidelines in a manner that will facilitate understanding and compliance by all ERCOT employees.

Since a redline document would have been more confusing than enlightening, ERCOT Legal will be prepared at the Committee's meeting to identify the parts of CS5.18 that have remained the same and which have been re-organized or revised.



Key Factors Influencing Issue:

For the reasons detailed above, ERCOT Legal suggests that the revision to CS5.18 will ensure that meaningful employee conflicts of interest will be identified and prevented, while not preventing employee activity that serves productive purposes. The proposed revision will also enable ERCOT to maintain consistency with the stock ownership prohibitions in effect at other ISO/RTOs.

There is no legal or regulatory requirement to revise CS5.18 at this time, but ERCOT Legal urges that the proposed changes will improve the content of the Standard, and ultimately assist ERCOT in maintaining compliance with the Standard.

Conclusion/Recommendation:

ERCOT staff recommends that the HR&G Committee recommend and Board approve the revisions to CS5.18 described above and included as Exhibit A to this decision template, to be effective upon Board approval.



ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.
BOARD OF DIRECTORS RESOLUTION

WHEREAS, after due consideration of the alternatives, the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) deems it desirable and in the best interest of ERCOT to approve revisions to CS5.18 Conflicts of Interest Corporate Standard, to be effective immediately, that would:

- Update ERCOT's policy on investments by ERCOT employees in the securities of Market Participants to be consistent with changes approved for other Independent System Operators / Regional Transmission Operators (ISO/RTOs);
- Revise the existing guidelines for receipt of goods and services by ERCOT employees from Market Participants and vendors utilized by ERCOT (Vendors); and
- Improve the clarity, effectiveness, and administrative efficiency of CS5.18 generally.

THEREFORE, BE IT RESOLVED, that ERCOT is hereby authorized and approved to amend CS5.18 Conflicts of Interest Corporate Standard consistent with the document attached hereto as Exhibit A, to be effective immediately.

CORPORATE SECRETARY'S CERTIFICATE

I, Vickie G. Leady, Assistant Corporate Secretary of ERCOT, do hereby certify that, at its April 8, 2014 meeting, the ERCOT Board passed a motion approving the above Resolution by _____.

IN WITNESS WHEREOF, I have hereunto set my hand this ____ day of April, 2014.

Vickie G. Leady
Assistant Corporate Secretary

ERCOT CORPORATE STANDARD

Document Name:	CS5.18 Conflict of Interest Corporate Standard
Document ID:	CS5.18
Effective Date:	Upon Approval by the ERCOT Board of Directors
Owner:	Vice President, General Counsel and Corporate Secretary
Governs:	ERCOT Employees
Approved:	President & CEO, and ERCOT Board of Directors

5.18.1 Purpose: Employees of ERCOT agree to conduct the Company's business in accordance with the ERCOT Code of Conduct, as reflected in the annual re-affirmation of compliance with the Code of Conduct in the Employee Ethics Agreement. This Corporate Standard provides more detailed guidance on what ERCOT requires of employees to prevent conflicts of interest, or situations that may result in the appearance of conflicts of interest.

5.18.2 Issues Addressed: ERCOT employees shall not put themselves in a position in which their personal interests might conflict with ERCOT's interests, or compromise ERCOT's ability to perform any of its duties in a fair and impartial manner. Due to ERCOT's role in the electricity market, ERCOT employees must make special efforts to avoid conflicts – or the appearance of conflicts – with Market Participants and Vendors of products or services. Potential conflicts of interest can arise in several circumstances for ERCOT employees. CS5.18 addresses, and provides specific guidance and requirements, regarding the following:

- (1) Ownership of securities of Market Participants or Vendors (CS5.18.5);
- (2) Personal or family interests in, or employment by, Market Participants or Vendors (CS5.18.6);
- (3) Goods or services provided to employees by Market Participants or Vendors (CS5.18.7); and
- (4) Prohibited activities and obligations to report them (e.g., abuse of position; attempted bribes or kickbacks) (CS5.18.8).

CS5.18.4 also establishes the process for reporting and resolving potential conflicts identified through the application of this Corporate Standard.

Employees should note that this Corporate Standard provides the minimum requirements for avoiding conflicts of interest at ERCOT. Depending on the work done by certain groups within the Company, the employees in that group may

believe it appropriate to self-impose other restrictions in order to prevent the appearance of conflicts. Employees should consult with the managers or directors to determine if such additional voluntary requirements apply to a particular group within the Company.

5.18.3 Definitions: As used herein, the following terms will have the meaning indicated:

“Dependent Party” means an ERCOT employee’s dependent child(ren), spouse or domestic partner.

“Market Participant” means an entity, other than ERCOT, that engages in any activity that is in whole or in part the subject of the ERCOT Protocols, regardless of whether that entity has signed an agreement with ERCOT. (The list of Market Participants can be found on ERCOT.com, under the “Committees and Groups” tab.)

“Mutual Fund” is an investment entity that brings together money from many people and invests in stocks, bonds, or other assets. The combined holdings of stocks, bonds, or other assets the fund owns are known as its portfolio. Each investor in the fund owns shares, which represent a part of these holdings.

“Related Party” means an ERCOT employee’s non-dependent child, parent, sibling, and any other individual who lives in the employee’s household.

“Vendor” is a supplier of goods or services to ERCOT that is included in the ERCOT Qualified Vendor List (QVL). (The QVL can be found on the ERCOT Contract Administration & Procurement SharePoint site.)

5.18.4 Reporting and Determination of Conflicting Interests: ERCOT employees are required to submit a signed Employee Ethics Agreement annually, and to disclose potential conflicts. Employees should also report to Human Resources additional potential conflicts any time it becomes reasonably apparent to the employee that such a conflict may exist. Should a reported conflict require action by the Company, the employee will be notified by Human Resources or Legal. The actions taken by the Company may include:

- Require that the employee eliminate the conflict of interest;
- Provide written consent from ERCOT management authorizing the employee to continue employment with the Company in spite of the conflict (including requiring the employee to comply with conditions of employment necessary for the Company to consent to the conflict); or
- Terminate the employment of the employee.

5.18.5 Ownership of Securities of Vendors and Market Participants: In order to ensure its neutrality in the administration of its markets and its dealings with Vendors and Market Participants, ERCOT must take reasonable measures to ensure its employees do not have a material interest in a Vendor or Market Participant that could affect the employee's judgment. In the case of the ownership of securities in a Vendor or Market Participant, employees must comply with the following:

A. Vendors. An employee or Dependent Party may hold securities issued by a Vendor if the securities owned by the employee or Dependent Party constitute less than 1% of the outstanding stock of the Vendor, unless the employee or Dependent Party would be in a position to influence a contract large enough to affect the market price of the securities. If the employee or Dependent Party believes he or she is in such a position of influence regarding a particular transaction with the Vendor, the employee should report the situation to Human Resources.

B. Market Participants. Employees are generally prohibited from owning the securities of companies participating in the ERCOT market whose primary activities are in the electric business. Some Market Participants are not primarily engaged in the electric business (e.g., certain financial institutions or retail sales companies), and their participation in the ERCOT market does not constitute a significant portion of their revenues. ERCOT seeks to take a balanced approach regarding employee ownership of the securities of this category of Market Participants, and applies the following test (which has been approved by federal regulators for use by other Independent System Operators and Regional Transmission Organizations) to determine whether stock ownership by employees is allowed:

ERCOT employees and Dependent Parties may not own the securities of a Market Participant that has been active in ERCOT markets in the previous 12 months, or the securities of its Affiliates, if: (1) the Market Participant or Affiliate is an electric sector company based on its North American Industry Classification System (NAICS) classification or otherwise determined by ERCOT; or (2) the total activity in the ERCOT markets (purchases and sales) for all Market Participants affiliated with the publicly traded company at issue during its most recently completed fiscal year is equal to or greater than 0.5 percent of its gross revenues for the same time period; or (3) the total activity in the ERCOT markets (purchases and sales) for all Market Participants affiliated with the publicly traded company at issue during the prior calendar year is equal to or greater than three percent of the total ERCOT market activity (purchases and sales) for the same time period.

ERCOT will maintain, and make available to employees, a list of the Market Participants whose stock is an eligible investment under this Standard, and will update the list as needed.

C. Mutual Funds. Employees may not participate in Mutual Funds that invest solely in businesses that operate in the electric industry sector. Employees may participate in independently managed Mutual Funds that invest in the securities of Vendors or Market Participants as part of a broader portfolio or investments.

5.18.6 Personal or family interests in, or employment by, Market Participants or

Vendors: The following situations involve conditions in which an employee might appear to show undue favoritism to a Market Participant or Vendor because the employee or a Dependent or Related Party has financial interests in a Market Participant or Vendor. Employees must report the existence of these situations to Human Resources as part of their annual re-affirmation of the Employee Ethics Agreement, and should also report additional situations to Human Resources any time it becomes reasonably apparent to the employee that such a situation may exist. These types of conflicts are only permissible if the employee obtains written consent from management (and can demonstrate compliance with any conditions attached to management's consent):

The employee or a Related or Dependent Party:

- Is employed by, or provides independent contracting services for, a Vendor or Market Participant; or
- Has a material interest in any transaction or proposed transaction to which the Company or any Market Participant (except for the retail purchase of electricity) is, or may become, a party.

The employee or a Dependent Party maintains a financial interest (other than ownership of stock or other securities of publicly-traded companies) in a Vendor or Market Participant. If the employee is in a position to influence the selection of a Vendor, this conflict should also be reported regarding persons or companies seeking to become Vendors with ERCOT.

An employee who is a decision-maker or influencer of decisions made by ERCOT who hopes to obtain future employment with a particular Market Participant or Vendor has a conflict of interest. Accordingly, any ERCOT employee who either raises or participates in a discussion with a Market Participant or Vendor (or a consultant or other representative of a Market Participant or Vendor) regarding the prospect of future employment for himself (or a Related or Dependent Party) is in violation of this corporate standard and is subject to appropriate disciplinary action unless he or she completely removes himself or herself from the position of decision-maker or influencer with regard to such person or entity.

5.18.7 Goods or services provided to employees by Market Participants or

Vendors: A conflict of interest arises if an employee is offered a gift by a Market Participant or Vendor, where such gift is being made to influence the employee's actions in his or her position with ERCOT, or where acceptance of the gift would reasonably create that impression.

For this reason, ERCOT employees may not accept gifts from Market Participants or Vendors. While the person offering the gift on behalf of the Market Participant or Vendor may not be seeking undue influence, the best practice for ERCOT employees is to inform Market Participants and Vendors that we cannot accept gifts due to ERCOT's role in the administration of its markets, and that gifts will be returned if they are sent to ERCOT employees.

Non-cash nominal gifts and meals customarily provided in the ordinary course of business will generally not give rise to a conflict of interest. Nominal gifts are items with token or modest value that will not place ERCOT employees under any real or perceived personal obligation to the donor. For example, if a Vendor provides a keychain or other trinket featuring its logo, or an industry or technical conference includes food or drinks provided as a courtesy to all attendees, an employee's acceptance of such items would not constitute a conflict of interest.

In the case of meals or other expenses totaling approximately \$30.00 or less that a Market Participant or Vendor offers to pay on behalf of an employee, each employee should apply the following test (and consult with his or her manager when in doubt):

If the expense involved is one that the employee could not be reimbursed for under the standards of ERCOT's *Business Expense Reimbursement Corporate Standard* (CS3.5), then the employee may not accept the goods or services provided by the person on behalf of the Market Participant or Vendor.

For example, if an ERCOT employee is participating in a stakeholder meeting that includes a working lunch and a Market Participant offers to cover lunch expenses for those in the meeting, the employee may accept the offer. The employee could have requested reimbursement from ERCOT for the working lunch as a business expense; therefore, the employee could accept the offer of the lunch from the Market Participant.

On the other hand, if an ERCOT employee participated in a social gathering with a group including Market Participants outside working hours, the employee's expenses would not be reimbursable as a business expense, and the employee could not accept a Market Participant's offer to pay associated expenses. Similarly, an offer to pay for alcoholic beverages for an ERCOT employee may never be accepted because ERCOT does not reimburse employees for the purchase of alcohol.

If the circumstances involve more than the nominal expenditures described above (goods or services valued above approximately \$30.00), the employee should consult with his or her manager to determine whether the payment is permissible.

For example, ERCOT experts are sometimes offered travel and lodging expense payments when they are invited to be speakers at conferences. In some circumstances, ERCOT would reimburse the employee for attendance at the conference because it serves a legitimate business purpose; in others, the business purpose may be insufficient to justify expenditure of ERCOT funds.

If management determines that the expenditure could not be reimbursed for business reasons, the employee should not accept payment of the expenses on behalf of a Market Participant or Vendor. The business purpose involved would not in that case overcome the potential conflict involved in accepting the payment from a Market Participant or Vendor. If management determines that the payment is appropriate, the employee and his or her director should document that decision (e.g., by email) before the employee accepts the offer from the Market Participant or Vendor, and retain the documentation for one year following the determination.

5.18.8 Prohibited Activities and Obligations to Report Them: Certain activities pose unacceptable conflicts of interest no matter the circumstances (and may also be illegal). These activities are prohibited for any ERCOT employee. If employees observe someone else engaging in these activities, they should report it immediately to Human Resources.

- Payment or acceptance of bribes, kickbacks or other improper payments while conducting the Company's business is strictly prohibited. This prohibition applies to dealing with current or potential ERCOT members, Market Participants, regulatory authorities, Vendors, contractors, sub-contractors, consultants, or other parties seeking to establish a business relationship with the Company.
- Inappropriate Use of ERCOT Employment: ERCOT strongly prohibits the use of position, title or employment status at ERCOT to inappropriately influence for personal gain or benefit. This includes the use of ERCOT letterhead or signature line to influence individuals or companies for personal gain or benefit.
- Misuse of Company Equipment or Tools: The use of Company equipment or tools for unauthorized projects, such as:
 - Company-owned funds, services, supplies or equipment will not be used for any sort of personal gain or benefit.

- Use of a Company provided personal computer to access or store inappropriate information (for more details on this issue, please review CS 7.1, *Acceptable Use Corporate Standard*).

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