

**PROJECT NO. 25959**

<b>RULEMAKING ON OVERSIGHT OF</b>	<b>§</b>	<b>PUBLIC UTILITY COMMISSION</b>
<b>INDEPENDENT ORGANIZATIONS IN</b>	<b>§</b>	<b>OF TEXAS</b>
<b>THE COMPETITIVE ELECTRIC</b>	<b>§</b>	
<b>MARKET</b>	<b>§</b>	

**ORDER ADOPTING AMENDMENTS TO SUBSTANTIVE RULE §25.361 AND  
NEW SUBSTANTIVE RULE §25.362 AS APPROVED AT THE  
FEBRUARY 13, 2003 OPEN MEETING**

The Public Utility Commission of Texas (commission) adopts an amendment to §25.361, relating to Electric Reliability Council of Texas (ERCOT), and new §25.362, relating to Electric Reliability Council of Texas (ERCOT) Governance, with changes to the proposed text as published in the October 11, 2002 *Texas Register* (27 TexReg 9528). The amendment and new rule establish standards for the operation of an independent organization in the competitive electric market in Texas.

An independent organization performs special functions in the market that are prescribed by statute, involving the development and implementation of rules and operating systems to manage the reliability of the electric network and facilitate retail competition in the sale of electricity. It operates in an environment in which many companies may buy and sell electricity at wholesale, schedule electricity for transmission to customers, and deliver electricity to serve the needs of retail customers, and in which retail customers have the ability to switch retail providers. The new rules establish standards for the governance of the independent organization operating in Texas to ensure that, in carrying out its duties, it considers the interests and solicits the views of persons who are interested in the electric market, to further the efficient operation of the wholesale and retail markets and the reliable operation of the electric network. The rules also

require that an independent organization allow access to meetings and information concerning its operations. Finally, the rules establish requirements related to reporting to the commission and compliance with commission rules. A companion rule, new §22.251 of this title (relating to Review of Electric Reliability Council of Texas (ERCOT) Conduct), was proposed at the same time as this amendment and new rule and is being adopted in a companion order. These rules are adopted under Project Number 25959.

A public hearing on the amendment and new rule was held at commission offices on December 3, 2002, at 9:30 a.m. A representative from the Electric Reliability Council of Texas (ERCOT) attended the hearing and provided comments. To the extent that these oral comments differ from the written comments, such comments are summarized herein.

The commission received comments on the proposed amendment on November 12, 2002 from Constellation New Energy, Inc., Green Mountain Energy Co., and Strategic Energy Co., through the Alliance for Retail Marketers (ARM); American Electric Power (AEP); the City of Austin, doing business as Austin Energy, and the City of San Antonio, acting by and through the San Antonio City Public Service Board (City Utilities); CenterPoint Energy, Inc. (CenterPoint); a coalition of consumer groups consisting of Texas Ratepayers' Organization to Save Energy, Texas Legal Services Center, Consumers Union Southwest Regional Office, and Public Citizen Texas Office (Consumers); ERCOT, the Lower Colorado River Authority (LCRA); Reliant Resources, Inc. (Reliant); and TXU Energy Trading Company, TXU Energy Retail Company,

L.P, and Oncor Electric Delivery Co. ( collectively, TXU). Reply comments were received from ERCOT and TXU on November 25, 2002.

The commission posed three questions in the preamble to the proposed rule. Because the questions relate to specific subsections of the proposed new rule, the comments filed in response to these questions are summarized together with the comments on the relevant subsections.

1. How should proposed §25.362(g) be changed to accommodate ERCOT's transition from a stakeholder board to a hybrid stakeholder/independent board?
2. Is the requirement in proposed §25.362(i)(3) for a third-party auditor consistent with the Non-unanimous Settlement in Docket Number 23320, *Petition of the Electric Reliability Council of Texas for Approval of the ERCOT Administrative Fee*, Item No. 10, which requires ERCOT to retain an internal auditor?
3. Should proposed §25.362 include a requirement that ERCOT adopt a mechanism for allocating administrative penalty liabilities, such as applying it to line-items in the ERCOT budget or assessing it to members? If "yes," to whom, and/or to what ERCOT budget items, should such a mechanism apply? Do other ISO's have such mechanisms?

*§25.361, Electric Reliability Council of Texas (ERCOT)*

TXU commented that assessing creditworthiness and ensuring necessary and adequate security for market participants relative to their role and responsibility in the market, and administering settlement and billing functions and systems, should be added to §25.361(c), as they are key functions of ERCOT.

The commission agrees with TXU that ensuring necessary and adequate security and administering settlement and billing functions and systems are key functions of ERCOT and has inserted a new §25.361(c)(2) to include the recommended functions. The responsibility for assessing creditworthiness would apply to obligations in markets operated by ERCOT.

Consumers recommended that §25.361(c)(9) be amended to better describe the process for registration of market participants, and specifically to include a requirement that ERCOT test the systems of every company in the Texas market to assure that they are able to fully communicate with the ERCOT system. In reply comments, TXU stated that while it agrees that the testing of certain systems should be and is an ERCOT function, ERCOT does not test the systems of every company it registers, and not all registered market participants are required to fully communicate with the ERCOT system. TXU argued that the requirements for system communication between ERCOT and market participants vary with the type of market participant. TXU recommended that the commission not adopt Consumers' recommendation relating to testing of market participant communication systems.

ERCOT filed reply comments stating that the Consumers' recommendations in §25.361(c) would add unnecessary detail to the list of ERCOT functions set forth in the commission rules. ERCOT stated that it supports the more general language used by the commission in the proposed rules, as they allow the commission greater flexibility in its oversight of ERCOT.

The proposed rule requires ERCOT to "administer procedures for the registration of market participants" and "administer the customer registration system." The commission concludes that the additional detail suggested by Consumers is not necessary, because administering these systems implies that ERCOT will conduct testing to ensure that they operate properly. Consumers' recommendation has not been incorporated into the rule.

Consumers noted that proposed §25.361(c)(10) would direct ERCOT to "administer the customer registration system." Consumers stated that ERCOT's responsibilities are broader than "administering" and therefore recommended that the rule be amended to require that ERCOT "design, develop, manage, and operate the customer registration system."

The commission agrees with Consumers that ERCOT's responsibilities in regard to the registration system are broader than simple administration. The relevant provision is now §25.361(c)(11) and has been modified to reflect ERCOT's broader responsibility.

ERCOT noted that proposed §25.361(c)(13) would require ERCOT to "disseminate information ... in accordance with the ERCOT protocols." ERCOT then noted that §25.361(c)(15) would require ERCOT to "perform any additional duties required under the ERCOT protocols." ERCOT expressed the view that these provisions are redundant and recommended that (c)(13) be deleted.

The commission declines to make the change recommended by ERCOT. While technically, proposed §25.361(c)(15) encompassed proposed §25.361(c)(13), the same can be said for other listed functions as well. The commission sees no harm in separately listing the requirement for ERCOT to disseminate information, as it is a specific function of particular importance. In addition, the protocols could be changed at some time in the future to eliminate or modify this duty, while §25.361 is intended to be a broader, but more durable statement of ERCOT's responsibilities. The third sentence of §25.361(g) also refers to the provision of information and is largely duplicative of the requirement in §25.362(e). Accordingly, this sentence is being modified to refer to §25.362(e).

Consumers recommended that Critical Transmission Projects be defined in the context of §25.361(c)(14), as ERCOT is required to submit a report to the commission identifying existing and potential transmission and distribution constraints and system needs within ERCOT with emphasis on critical transmission projects. Currently, however, critical transmission projects are not defined within §25.361. Consumers proposed that critical transmission projects be defined as projects needed to meet areas of growth in demand or potential areas where generation is

concentrated. They also proposed that the commission annually review ERCOT's report, develop a five year plan for transmission updates, and pre-approve needed construction.

The commission agrees that there are important issues relating to the transmission planning process that warrant commission attention. It does not believe that these issues have been adequately explored in this rulemaking project, so as to amend this rule now. Rather, it is the commission's intention to consider changes in the transmission planning process and possible changes in the rules relating to transmission planning and licensing later in 2003. No changes have been made to the language of the rule to reflect this recommendation.

CenterPoint proposed to modify a portion of §25.361(g) to require ERCOT to maintain the confidentiality of Critical Infrastructure Information, as specified in §25.362 of this title (relating to Electric Reliability Council of Texas (ERCOT) Governance).

The commission agrees with CenterPoint's concern. The confidentiality protection in §25.362 is broader than the protection in §25.361, which relates only to competitively sensitive information. Section 25.361(g) has been modified to refer to the confidentiality provision in §25.362. Changes to §25.362(e) are discussed below.

*§25.362, Electric Reliability Council of Texas (ERCOT) Governance*

*§25.362(c), Adoption of rules by ERCOT and commission review*

CenterPoint contended that the proposed rule's efforts at creating an "open government" approach at ERCOT will impede ERCOT's ability to act quickly and decisively when market conditions warrant. Specifically, CenterPoint noted that the provisions of §25.362(c), in effect, subject ERCOT to the same rules and restrictions as a government administrative agency. The unintended result would be a slow-down in ERCOT's decision-making process. TXU expressed a similar view that the requirement for ERCOT to evaluate the cost and benefits to the organization, market participants, and retail customers as part of the process for revising protocols and procedures would impede timely action by ERCOT. TXU noted that the cost/benefit requirement could be interpreted to apply to practically every statement that ERCOT makes.

ERCOT suggested that references to ERCOT "rules" could lead to confusion about whether the matter referred to was a commission rule or an ERCOT protocol or procedure, noting that the commission rules are different and are a higher source of authority than ERCOT protocols or procedures. ERCOT stated that to eliminate this potential for confusion, this rule should consistently refer to "Commission Rules" and "ERCOT procedures."

The proposed rule was based on the recognition that ERCOT has an important function in developing market and reliability rules, which are set forth in ERCOT protocols and procedures. Prior to the publication of the proposed rule, a number of parties expressed frustration with the



process by which the protocols and procedures are developed. They said that it was difficult to learn about proposed changes in the protocols and difficult to present information and argument concerning proposed protocol changes that would have impact on their development. The provisions on public notice and analysis of the cost and benefits when ERCOT intends to change a protocol would ensure that interested persons have the opportunity to participate in this process and that ERCOT evaluates the changes adequately. In addition, in §22.251, which is being adopted in a companion order, the commission sets out how it will review ERCOT actions, including protocol revisions. These rules should facilitate participation in the protocol development process by interested persons and clarify how the commission will conduct its oversight of ERCOT. The commission believes that they will not unduly impede ERCOT's decision-making process. The commission recognizes that not all ERCOT pronouncements should require a cost/benefit analysis, and has revised the rule to narrow the scope of this requirement. The commission agrees with ERCOT that commission rules are not the same as ERCOT protocols or procedures. In order to eliminate any potential confusion, changes have been made to the language of the rule to consistently refer to ERCOT "protocols" or "procedures." These are the terms commonly used to refer to the ERCOT market and reliability rules.

*§25.362(d), Access to meetings*

Similar to its comments concerning §25.362(c), CenterPoint argued that the "open government" approach at ERCOT would impede ERCOT's ability to act quickly and decisively when market

conditions warrant. Specifically, CenterPoint noted that the provisions of §25.362(d), in effect, would subject ERCOT to the same rules and restrictions as a government administrative agency. The unintended result would be a slow-down in ERCOT's decision-making process. TXU recommended that access to meetings be more narrowly defined to those meetings wherein a formal vote would be taken. TXU argued that under the proposed rule, as written, any meeting or discussion at ERCOT by two or more staff members would be subject to this provision.

ERCOT recommended that the rule allow notice of meetings to be posted on the website and by email. ERCOT also recommended that permanent retention of meeting records be limited to the Board of Directors, and that the records for other meetings (such as standing committees and subcommittees) be limited to a five-year retention period.

The commission recognizes the concern expressed by CenterPoint and TXU relating to the provision in the proposed rule on open meetings. The rule directs ERCOT to establish a policy on opening meetings to the public. If there are categories of meetings that are not appropriate for opening to the public, the policy adopted by ERCOT can specify which meetings those are. The commission does not believe that a modification of the proposed rule is needed to address these concerns and believes that the rule gives ERCOT discretion to address this matter. The commission concurs that website and email posting of meetings are appropriate and believes that the rule gives ERCOT discretion to address appropriate notice mechanisms. Additionally, the commission agrees with ERCOT that the provision on record keeping should be modified; it is

appropriate that board records be retained permanently and that ERCOT establish reasonable retention periods of not less than five years for all other meeting records.

*§25.362(e), Access to information*

ARM recommended that the rule be modified to require ERCOT to provide non-confidential information on a timely basis, because much of the information that is of interest is time-sensitive. ARM identified the ten-day requirement of the Texas Public Information Act (TPIA) as a standard to use. In reply, ERCOT argued that a ten-day delivery requirement is not appropriate, because of the large volume of information processed by ERCOT.

The commission agrees with ARM that non-confidential materials should be provided on a timely basis and believes that the ten-day standard is appropriate. While ERCOT processes a large volume of information, it is not clear that the volume of requests for information would present significant problems for it. In addition, as ARM has pointed out, much of the information that is likely to be requested is time-sensitive, so that prompt delivery is important to the person requesting the information. The commission has also modified the provisions of subsection (e) concerning the provision of information to the commission to require that this information be provided promptly.

*Confidentiality*

ERCOT, Consumers, and ARM generally agreed with the approach taken in the proposed rule with respect to the treatment of confidential information. ARM noted that the Public Utility Regulatory Act (PURA) requires the commission to maintain the confidentiality of competitively sensitive information, and said that the rule appears to do so.

LCRA, Reliant and TXU commented that subsection (e) impermissibly places the commission in the role of determining what information is or is not subject to an exception to the TPIA, a responsibility that the TPIA reserves to the attorney general. TXU said that absent an agreement concerning the disclosure of protected information, the commission should commit to seeking an Attorney General opinion. LCRA added that the process and timetable set forth in subsection (e)(8) would allow the commission to substitute its judgment about whether information may be withheld for that of the Attorney General, under a process that differs from that in the TPIA and which irrevocably prejudices the owner of the information. Specifically, LCRA noted that while the proposed rule requires commission notification to parties within ten days of the receipt of a request for release, the TPIA requires the commission to request an Attorney General opinion within ten days of the request. LCRA said that if the commission were to agree that the information is protected, it would be too late to follow the procedures set forth in the TPIA and the ability to withhold the information would be lost. TXU suggested extending the proposed rule's 72-hour notice of the commission's intention to disclose protected information so that weekends would be excluded.

Reliant argued that the rule contained no indication of what standard the commission would employ in determining whether information designated as confidential or "protected" would be disclosed. The company said further that information deemed confidential under the protocols will have already been reviewed and approved by the commission, and that there is no basis for the commission to revisit decisions related to confidentiality. According to Reliant, if the commission were to establish a procedure to second-guess ERCOT's determination of confidentiality, ERCOT would be hampered in performing its job.

The City Utilities argued the proposed rule also conflicts with portions of the TPIA that apply to municipally owned utilities. They said that under §552.133 of the TPIA, with respect to "competitive matter" information designated by a municipally owned utility, only the governing body of the utility and the attorney general are authorized to make determinations regarding protection and release of information. The two cities said the rule should expressly recognize the presumption that Protected Information is confidential information under the TPIA. They also called for reversing the meaning of subsection (e)(3) so that the commission would have discretion to disclose information only if the ERCOT protocols do not designate the information as protected.

ERCOT, however, supported the commission's approach regarding public access to information. The proposed rule would require ERCOT to develop procedures to provide information, and ERCOT noted that it has already adopted such procedures.

Centerpoint said that critical infrastructure information, including maps, should also be withheld from public disclosure, in the interest of guarding against terrorist attacks or other threats to the physical security of the electric grid.

The commission has extensively reorganized subsection (e) to make it clearer. In particular, the subsection has been divided into two paragraphs, the first of which deals with information in ERCOT's possession and the second of which deals with information in the commission's possession.

The commission agrees with Reliant that there is no need to revisit decisions on confidentiality as a routine matter, and the commission does not believe that the adoption of this rule would result in routine re-examination of decisions made by ERCOT. The purpose of the provision concerning commission review of ERCOT's decisions on confidentiality, now subsection (e)(1)(B), is to provide the commission with flexibility to deal with extraordinary situations in which there is a significant public interest in disclosing information that otherwise would be protected. As a part of its oversight responsibility, the commission should resolve whether disclosure of information is in the public interest. There are a number of instances in which the broad availability of information fosters the development of competitive markets. The commission has, for example, conducted a customer education campaign to provide customers basic information concerning the opportunities they have to shop for power in a competitive retail electric market. It has also helped distribute information about the prices that retail electric

providers are offering in the market. These efforts are based on the idea that better-informed consumers will result in a more vibrant competitive market and, hence, greater benefits from competition.

Dissemination of information about the operation of the wholesale market might also foster more vibrant competition. For example, if the commission were to learn that market participants were gaming market rules under a cloak of confidentiality, thereby artificially driving power prices higher (as was done in California), the commission would have a procedure by which it could determine whether the information is in fact competitively sensitive or should instead be made public. Conversely, the commission needs the tools in extraordinary circumstances to protect information that would ordinarily be disclosed under the protocols. It is equally necessary that a market participant have a procedure by which it can demonstrate to the commission that the release of certain information would cause it substantial competitive harm. Moreover, unforeseen events relating to the security of essential electric facilities may also require confidentiality measures not anticipated in the protocols. Accordingly, the new rule provides a mechanism by which the commission can make a determination as to whether information that is deemed confidential under the ERCOT protocols should be released and whether information that is not protected from disclosure should be protected. In all cases where this provision would be applied, affected parties would have reasonable notice and opportunity to present their positions prior to commission action.

With respect to the contention that the commission is required to refer all questions of confidentiality to the attorney general, the commission has modified the rule to make it clear that should a TPIA request be made and not resolved through informal dispute resolution efforts, the matter would be referred to the Attorney General in accordance with the TPIA. *See* §25.362(e)(2)(B). The commission concludes that the commenters are correct that where a third party has requested information that is in the commission's possession or available to it and the commission concludes that the information should not be released, the TPIA requires the commission to refer the matter to the Attorney General to resolve the question of whether the information must be released. Under the TPIA and Attorney General opinions interpreting this Act, a governmental body may, but is not required to, resolve disputed issues of fact regarding whether information that has been requested comes within an exception to public disclosure when a third party's property or privacy rights are at issue. The rule as adopted preserves the commission's ability to exercise this option.

The rule would, however, allow the commission to remove the protected status of information in ERCOT's or the commission's possession in the absence of a request under the TPIA. PURA gives the commission the power to collect information from market participants and the responsibility to determine whether the information should be protected from disclosure to third parties, in certain circumstances. For example, PURA §39.155 requires persons who own electric generation facilities in the state to report information concerning the capacity of such facilities and the volume of sales. This section also directs the commission to prescribe reporting requirements that ensure the confidentiality of competitively sensitive information. This statute



provides the commission, rather than the Attorney General, authority to determine whether information provided under §39.155 should be disclosed to the public. In the event that the commission seeks to remove the protected status of information that any party deems confidential, that party would have an opportunity to present information concerning the nature of the information and whether it is entitled to continued protection. Furthermore, the subsection is intended to provide adequate time for an affected party to seek a court injunction if it disagrees with the commission's determination.

LCRA's concern about the timing of notice has been addressed by establishing a three-day notice requirement. If the commission receives a request for access to protected information it would make a good faith effort, within three business days of receipt of the request, to notify the person who has provided the information that a request has been received. *See* §25.362(e)(2)(B). Thus, the person who has provided the information would receive notice of the request, before or at the same time that the commission submits the matter to the Attorney General for a determination on whether the information is excepted from disclosure under the TPIA. The TPIA requires the agency to notify the information owner of its intent to request an attorney general opinion (TPIA §552.305) "*within a reasonable time* but not later than the tenth business day after the date of receiving the written request." (Emphasis added.) The modifications to the proposed rule are consistent with the TPIA and should provide parties adequate notice in order that they may protect their interests by presenting arguments and evidence concerning a request for information to the Attorney General.

The commission does not believe that the rule, as modified, is inconsistent with the City Utilities' rights under TPIA §552.133. To the extent that the commission receives a request for the disclosure of information owned by a municipal utility, the utility will have an opportunity to present information to the Attorney General supporting its contention that the information is protected from disclosure under that provision. If the Attorney General decides that the information is not protected under the TPIA, the commission would be required to give advance notice to the utility of the decision to release the information. If the utility disagrees with the determination, it should have time to seek an injunction to prevent the release of the information. If the commission seeks to release information that is owned by a governmental body in the absence of a request for the information, the governmental body will have an opportunity to present evidence to the commission on the issue of the statutory exception to public disclosure created by TPIA §552.133.

The commission agrees with TXU's suggestion that the 72-hour notice discussed in proposed subsection (e)(7) should exclude weekends. The notice period has been changed to three business days. *See* §25.362(e)(2)(B), (E).

Finally, under the new rule ERCOT is required to protect information that it has designated as protected from disclosure. This subsection gives ERCOT latitude in determining the information that should be protected, and it would have the discretion to adopt protocols or procedures to protect information if its release might imperil the security of critical electric facilities. In the

commission's view, this accommodates CenterPoint's concern, and it is not necessary that the rule require ERCOT to withhold critical infrastructure information from public disclosure.

*Preamble question 1 and §25.362(g), Qualifications for membership on governing board*

Preamble question 1 asked how proposed §25.362(g) should be changed to accommodate ERCOT's transition from a stakeholder board to a hybrid stakeholder/independent board. AEP recommended that ERCOT not reserve seats on the board for individuals with experience in specific disciplines. AEP stated that the members should have a background in finance, accounting or law or, preferably, a combination of these disciplines. ARM recommended that the rule be changed to provide separate membership requirements for the independent board members. Specifically, independent board members should have absolutely no connection to market participants or to any other ERCOT non-commercial member (such as the commission or a consumer group). ARM further stated that the criteria should not rule out individuals with experience in the electric industry or a similar field, such as a former electric industry employee or a former commissioner or commission employee.

ARM also recommended that the rule establish restrictions on the board members similar to those applicable to sitting commissioners, including a one-year post-employment prohibition. ARM recommended that the board qualifications not include a requirement for level of activity in the ERCOT market, as this would make it difficult for smaller and newer market participants to gain board representation. Consumers recommended adding a subsection establishing a

revolving door policy, disqualifying for a seat as an independent board member a person who has recently been employed by a market participant. Consumers supported standards for "good standing" for ERCOT board members. TXU agreed with the need for a revolving door policy, but expressed the view that this is an area that should be addressed by an ERCOT policy rather than in a commission rule. In reply comments, ERCOT asserted that Consumers' recommendations in this regard are overly proscriptive and punitive.

Reliant did not believe that any changes were necessary in the proposed rule. TXU stated that a revision to the proposed rule is not necessary to address a hybrid board consisting of stakeholder and independent directors, because ERCOT's by-laws, which are subject to review and approval by the commission, contain the details of the board structure. TXU also stated that the proposed rule, as written, provides adequate qualification requirements for board membership. Additionally, TXU pointed out that Docket 26861, *Petition of the Electric Reliability Council of Texas (ERCOT) for Approval of Governance Changes*, has been initiated to consider the proposed ERCOT by-law changes that implement a blended board. CenterPoint expressed the view that proposed §25.362(g) is not necessary, because ERCOT's by-laws provide sufficient detail and are subject to commission review and approval.

The commission concurs with Reliant and TXU that a change to proposed §25.362(g) is not necessary. The Final Order in Docket Number 26861 (Dec. 9, 2002) approved the hybrid board and its structure. The ERCOT by-laws (Article 34) provide a sufficient definition and independence criteria for the independent directors. ARM's suggestion of changing the rule is

not necessary, because changes in the by-laws relating to the membership of the board require commission review, to determine that the resulting board structure will ensure the organization's independence.

The commission agrees with ERCOT that the guidelines for board membership, as set out in the proposed rule, §25.362(g)(1), are adequate and appropriate. The approach that was taken in this rule was to establish a number of policies that ERCOT must adhere to, but give it broad discretion in how to implement these policies. Among the broad policies addressed in the proposed rule are conflicts of interest. This provision would require ERCOT to consider whether it is appropriate to address such matters as qualifications and post-employment restrictions for independent board members. The commission also concludes that the "levels of participation" requirement is appropriate. This requirement is intended to ensure that board members that represent a sector of the market have some specific connection with the ERCOT market and the sector they would represent; it is not intended to preclude new market entrants or small market participants from serving on the board of directors.

*§25.362(i), Compliance with rules or orders, and Preamble questions 2 and 3*

Preamble question 2 asked whether the requirement in proposed §25.362(i)(3) for a third-party auditor was consistent with the non-unanimous Settlement in Docket Number 23320, *Petition of the Electric Reliability Council of Texas for Approval of the ERCOT Administrative Fee*, Item No. 10, which requires ERCOT to retain an internal auditor. AEP and Reliant commented that

the proposed rule requirement is not consistent with the settlement. AEP noted that the non-unanimous Settlement in Docket Number 23220 states, "The ERCOT Board agrees to employ an internal auditor to independently review fiscal matters, staffing, and expenses for ERCOT activities beginning no later than July 31, 2003. The internal auditor will report through quarterly written reports to the ERCOT Board." AEP argued that the requirement in the proposed rule should not be adopted. Reliant commented that the settlement identified specific circumstances in which ERCOT would hire an independent auditor, and to the extent that the proposed rule creates an additional situation in which ERCOT would be required to employ a third-party auditor, it is inconsistent with that settlement.

ARM, CenterPoint, and Consumers commented that the rule requirement is consistent with the settlement. ARM noted that the commission's authority to require ERCOT to submit to an audit stems from PURA and not from the parties' settlement. ARM argued that PURA grants the commission authority to oversee and review an independent organization's procedures relating to the reliability of the regional electric network and accounting for the production and delivery of electricity. In ARM's view, ERCOT's accounting for the costs incurred in rendering such services would constitute procedures related to reliability and accounting for production and delivery of electricity. ARM contended that the commission's rules should not defer to a settlement of parties, primarily because those same parties could by agreement modify their settlement or choose not to seek its enforcement. ARM also pointed to prior instances when the commission ruled on issues initially in a contested case and subsequently revisited those issues in a rulemaking of general applicability. CenterPoint commented that the audit requirement in

the settlement exists to assure ERCOT fee-payers that ERCOT's expenses and fees are reasonable and verifiable on an ongoing basis, while the audit requirement in the proposed rule exists as a remedy or enforcement tool after ERCOT has failed to comply with PURA, the commission's substantive rules, or a commission order. CenterPoint argued that the two requirements serve different purposes, and are not necessarily inconsistent. Consumers commented that the rule provision would allow greater scrutiny by a truly independent third party (not an ERCOT employee) in instances of rule violations. Consumers noted that the commission may need to require audits of a specialized nature depending on the circumstances, and the draft rule would provide greater flexibility but would not substitute for the existing requirement that ERCOT hire an individual to perform routine internal audit functions.

The commission agrees with ARM, CenterPoint, and Consumers. PURA authorizes the commission to oversee an independent organization, which implies that the commission has the power to adopt special investigative and reporting requirements to ensure compliance with its rules. The flexibility of the requirement for a third-party auditor in the proposed rule is an appropriate enforcement tool for the commission's oversight of ERCOT. This auditor also has a different purpose, and the rule provisions relating to it are separate and independent from, the auditor addressed in the settlement. Therefore, the commission retains the requirement for a third-party auditor in §25.361(i)(3).

Preamble question 3 asked whether proposed §25.362 should include a requirement that ERCOT adopt a mechanism for allocating administrative penalty liabilities, such as applying it to line-

items in the ERCOT budget or assessing it to members. It also asked how such a mechanism should be applied and whether other ISOs have such mechanisms. AEP, Reliant, CenterPoint, and TXU stated that monetary penalties are inappropriate, because penalties fail to provide an incentive for good performance, and, in addition, such fines could ultimately be paid by market participants who are undeserving of the penalty. ERCOT and Reliant observed that penalties do not work well as an incentive for ERCOT, because ERCOT does not have shareholders and must pass on the penalties either in the form of fees or reduced services. Reliant recommended that if the commission does adopt a rule that allows for administrative penalties applicable to ERCOT, it should avoid a "one-size-fits-all" approach by adopting an allocation method as well.

TXU agreed that the commission's oversight authority should include a mechanism to ensure ERCOT compliance. Remedies such as revocation of the independent organization certificate, as well as reporting and auditing requirements, are appropriate methods of enforcement. However, TXU strongly disagreed with the provisions of the proposed rule that authorize administrative penalties against ERCOT as an enforcement tool. TXU recommended the deletion of proposed subsection §25.362(i)(4).

ARM commented that the rationale for assessing a penalty to market participants, through the administrative fee or otherwise, is that the market participants ultimately supervise ERCOT through the board structure. However, the introduction of independent board members dilutes this rationale. ARM recommended that the rule require that any market participant harmed by the conduct for which the penalty is being imposed be exempt from the assessment of the



penalty. ARM further proposed that the rule prohibit ERCOT from passing on to market participants penalties for conduct outside the authorized parameters for ERCOT operations (e.g., an individual staff member violates the protocols). Such penalties should be paid from the ERCOT personnel and training budget.

ERCOT recommended that the commission focus its enforcement efforts on compliance reporting and the suspension or revocation of ERCOT's Independent Organization certification. ERCOT noted, however, that if the commission does deem penalties appropriate, it should consider whether it has the authority to require all market participants to become ERCOT members so that ERCOT can pass through penalties to members rather than through its fees, which are charged to market participants. Further, ERCOT noted that it may need to address the possibility of penalties in its member agreements.

Consumers recommended that mandatory fines be imposed upon ERCOT and its members for non-compliance, provided that such fines are not passed on to consumers in any way. Consumers recommended that the commission require the ERCOT board to assess administrative penalties and legal fees associated with those penalties directly to all for-profit members of ERCOT. Consumers asserted that since the retail market opened on January 1, 2002, complaints filed by residential consumers against electric companies have increased, because oversight and enforcement are inadequate. Consumers expressed the view that complaints will continue to increase because there are no adverse consequences for rule violations. Consumers recommended setting uniform penalties for failure of ERCOT, REPs, and

TDUs to comply with commission rules and orders. Consumers proposed that penalties should be payable to the retail customer as a credit on the next electric bill. They added that residential consumers should have access to the performance measures of individual REPs. TXU disagreed with the Consumers' recommendation to remove the commission's enforcement discretion concerning the administrative penalties listed in §25.362(i). TXU asserted that this recommendation is unreasonable and would likely result in many cases of unwarranted enforcement.

While the commission agrees that administrative penalties are not the first step that should be taken in an instance of non-compliance by ERCOT, there may, in fact, be times at which such penalties are appropriate. Further, PURA §15.023 authorizes the commission to impose administrative penalties. The commission could assess a penalty under §15.023, regardless of whether this authorization is reiterated in the rule. The commission certainly views imposition of administrative penalties as less severe than the suspension or revocation of ERCOT's Independent Organization certification. The commission recognizes that there may be a degree of unfairness in assessing penalties against ERCOT that are then passed on to its members or to market participants through its administrative fee, as a number of commenters pointed out. The commission would consider the impact of a penalty in deciding whether to assess it and how to do so. It believes that in assessing a penalty, it would have to consider all of the circumstances and tailor the penalty to the fact situation. The preamble to the proposed rule posed the question whether the commission could assess a penalty directly against specific line items in ERCOT's budget. While this remedy is not explicitly included in the rule, the commission concludes that

penalties may appropriately be assessed against line items in the ERCOT budget, if the facts and circumstances warrant.

Many of the Consumers' recommendations merit further discussion, but are beyond the scope of this rule and did not receive adequate discussion in this rulemaking. The commission has reorganized its enforcement organization and is devoting more resources to the enforcement of rules than in the past. The commission also opened a rulemaking proceeding to review the customer protection rules, Project Number 27084, *Rulemaking to Revise Customer Protection Rules*. That project is a more appropriate forum for the discussion of these ideas. Therefore, no changes to the proposed rule are required. The other issues raised by ARM need not be addressed in this rule, but could be resolved in connection with a future proceeding in which an administrative penalty is proposed.

All comments, including any not specifically referenced herein, were fully considered by the commission. In adopting these sections, the commission makes other minor modifications for the purpose of clarifying the rules.

This amendment and new section are adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2003) (PURA), which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, §39.151, which authorizes the commission to certify an independent organization or organizations to perform prescribed functions, to oversee the

procedures adopted by an independent organization relating to the reliability of the regional electrical network and accounting for the production and delivery of electricity among market participants, to establish and oversee transaction settlement procedures, and to establish terms and conditions for the ERCOT independent system operator's oversight of utility dispatch functions.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 39.151 and 39.155.

**§25.361. Electric Reliability Council of Texas (ERCOT).**

- (a) **Applicability.** This section applies to the Electric Reliability Council of Texas (ERCOT). It also applies to transmission service providers (TSPs) and transmission service customers, as defined in §25.5 of this title (relating to Definitions), with respect to interactions with ERCOT.
- (b) **Purpose.** ERCOT shall perform the functions of an independent organization under the Public Utility Regulatory Act (PURA) §39.151 to ensure access to the transmission and distribution systems for all buyers and sellers of electricity on nondiscriminatory terms; ensure the reliability and adequacy of the regional electrical network; ensure that information relating to a customer's choice of retail electric provider is conveyed in a timely manner to the persons who need that information; and ensure that electricity production and delivery are accurately accounted for among the generators and wholesale buyers and sellers in the region. In addition, ERCOT may, on the introduction of customer choice in the ERCOT power region, acquire generation-related ancillary services on a nondiscriminatory basis on behalf of entities selling electricity at retail in accordance with PURA §35.004(e).
- (c) **Functions.** ERCOT shall operate an integrated electronic transmission information network and carry out the other functions prescribed by this section. ERCOT shall:

- (1) administer, on a daily basis, the operational and market functions of the ERCOT system, including scheduling of resources and loads, and transmission congestion management, as set forth in the ERCOT protocols;
- (2) administer settlement and billing for services provided by ERCOT, including assessing creditworthiness of market participants and establishing and enforcing reasonable security requirements in relation to their responsibilities in ERCOT-operated markets;
- (3) serve as the single point of contact for the initiation of transmission transactions;
- (4) maintain the reliability and security of the ERCOT region's electrical network, including the instantaneous balancing of ERCOT generation and load and monitoring the adequacy of resources to meet demand;
- (5) direct the curtailment and redispatch of ERCOT generation and transmission transactions on a non-discriminatory basis, consistent with ERCOT protocols;
- (6) accept and supervise the processing of all requests for interconnection to the ERCOT transmission system from owners of new generating facilities;
- (7) coordinate and schedule planned transmission facility outages;
- (8) perform system screening security studies, with the assistance of affected TSPs;
- (9) plan the ERCOT transmission system, in accordance with subsection (f) of this section;
- (10) administer procedures for the registration of market participants;
- (11) develop, manage, and operate the customer registration system;
- (12) administer the renewable energy program;

- (13) monitor generation planned outages;
  - (14) disseminate information relating to market operations, market prices, and the availability of services, in accordance with the ERCOT protocols;
  - (15) submit an annual report to the commission identifying existing and potential transmission and distribution constraints and system needs within ERCOT, with emphasis on critical transmission projects, alternatives for meeting system needs, and recommendations for meeting system needs, pursuant to PURA §39.155 (relating to Commission Assessment of Market Power); and
  - (16) perform any additional duties required under the ERCOT protocols.
- (d) **Commercial functions.** ERCOT shall dispatch generation facilities only in accordance with the provisions of the ERCOT protocols. This responsibility includes authority to redispatch generation resources, in accordance with §25.200 of this title (relating to Load Shedding, Curtailments, and Redispatch) and the ERCOT protocols, and to determine and purchase the amount of ancillary services required to maintain and ensure the reliability of the network. All commercial functions required to ensure reliability and adequacy of the transmission network are to be conducted in accordance with the ERCOT protocols.
- (e) **Liability.** ERCOT shall not be liable in damages for any act or event that is beyond its control and which could not be reasonably anticipated and prevented through the use of reasonable measures, including, but not limited to, an act of God, act of the public

enemy, war, insurrection, riot, fire, explosion, labor disturbance or strike, wildlife, unavoidable accident, equipment or material shortage, breakdown or accident to machinery or equipment, or good faith compliance with a then valid curtailment, order, regulation or restriction imposed by governmental, military, or lawfully established civilian authorities.

- (f) **Planning.** ERCOT shall conduct transmission system planning and exercise comprehensive authority over the planning of bulk transmission projects that affect the transfer capability of the ERCOT transmission system. ERCOT shall supervise and coordinate the other planning activities of TSPs.
- (1) ERCOT shall evaluate and make a recommendation to the commission as to the need for any transmission facility over which it has comprehensive transmission planning authority.
  - (2) A TSP shall coordinate its transmission planning efforts with those of other TSPs, insofar as its transmission plans affect other TSPs.
  - (3) ERCOT shall submit to the commission any revisions or additions to the planning guidelines and procedures prior to adoption. ERCOT may seek input from the commission as to the content and implementation of its guidelines and procedures as it deems necessary.
- (g) **Information and coordination.** Transmission service providers and transmission service customers shall provide such information as may be required by ERCOT to carry



out the functions prescribed by this section and the ERCOT protocols. ERCOT shall maintain the confidentiality of competitively sensitive information and other protected information, as specified in §25.362 of this title (relating to Electric Reliability Council of Texas (ERCOT) Governance). Providers of transmission and ancillary services shall also maintain the confidentiality of competitively sensitive information entrusted to them by ERCOT or a transmission service customer.

- (h) **Interconnection standards.** In performing its functions related to the reliability and security of the ERCOT electrical network, ERCOT may prescribe reliability and security standards for the interconnection of generating facilities that use the ERCOT transmission network. Such standards shall not adversely affect or impede manufacturing or other internal process operations associated with such generating facilities, except to the minimum extent necessary to assure reliability of the ERCOT transmission network.
- (i) **ERCOT administrative fee.** ERCOT shall charge an administrative fee for transmission service in accordance with ERCOT protocols. Changes in the fee or application of new fees are subject to commission approval.
- (j) **Reports.** Each TSP and transmission service customer in the ERCOT region shall on an annual basis provide historical information concerning peak loads and resources connected to the TSP's system. ERCOT shall periodically file with the commission

reports concerning its governance, operations and budget, the reliability region of the ERCOT electrical network, and ERCOT's transmission planning efforts, including a list of any transmission projects that it recommends.

- (k) **Anti-trust laws.** The existence of ERCOT is not intended to affect the application of any state or federal anti-trust laws.

**§25.362. Electric Reliability Council of Texas (ERCOT) Governance.**

- (a) **Purpose.** This section provides standards for the operation of an independent organization within the ERCOT region.
- (b) **Application.** This section applies to ERCOT or any other organization within the ERCOT region that qualifies as an independent organization under the Public Utility Regulatory Act (PURA) §39.151.
- (c) **Adoption of rules by ERCOT and commission review.** ERCOT shall adopt and comply with procedures concerning the adoption and revision of protocols and procedures that constitute statements of general policy and that have an impact on the governance of the organization or on reliability, settlement, customer registration, or access to the transmission system.

- (1) The procedures shall provide for advance notice to interested persons, an opportunity to file written comments or participate in public discussions, and, in the case of new protocols or revisions to protocols, an evaluation by ERCOT of the costs and benefits to the organization and the operation of electricity markets.
  - (2) The commission shall process requests for review of ERCOT protocols, procedures, and decisions in accordance with §22.251 of this title (relating to Review of Electric Reliability Council of Texas (ERCOT) Conduct).
- (d) **Access to meetings.** ERCOT shall adopt and comply with procedures for providing access to its meetings to market participants and the general public. These procedures shall include provisions on advance notice of the time, place, and topics to be discussed during open and closed portions of the meetings, and making and retaining a record of the meetings. Records of meetings of the board of directors shall be retained permanently, and ERCOT shall establish reasonable retention periods, but not less than five years, for records of other meetings.
- (e) **Access to information.** This subsection governs access to information held by ERCOT and access to information held by the commission that it receives from ERCOT.
- (1) ERCOT shall adopt and comply with procedures that allow persons to request and obtain access to records that ERCOT has or has access to relating to the governance and budget of the organization, market operation, reliability, settlement, customer registration, and access to the transmission system. ERCOT

shall make these procedures publicly available. Information that is available for public disclosure pursuant to ERCOT procedures shall normally be provided within ten business days of the receipt of a request for the information. If a response requires more than ten business days, ERCOT will notify the requester of the expected delay and the anticipated date that the documents may be available. ERCOT's procedures regarding access to records shall be consistent with this section.

- (A) Information submitted to or collected by ERCOT pursuant to requirements of the protocols or operating guides shall be protected from public disclosure only if it is designated as Protected Information pursuant to the Protocols, except as otherwise provided in this subsection.
- (B) On its own motion or the petition of an affected party, including commission staff, the commission may, after providing reasonable notice to affected parties and an opportunity to be heard, amend the definition of "Protected Information" or the designation of "Items Not Considered Protected Information" under the ERCOT Protocols. In considering such an amendment, the commission may review the specific information under consideration or a general description of such information.
- (C) The procedures adopted by ERCOT under this subsection shall include provisions for promptly responding to a request from the commission or commission staff for information that ERCOT collects, creates or maintains in order to provide the commission access to information that

the commission or commission staff determines is necessary to assess market power and the development and operation of competitive wholesale and retail markets; to evaluate possible violations of laws, rules, protocols, or codes of conduct; or to carry out the commission's responsibilities for oversight of ERCOT.

- (2) Commission employees, consultants, agents, and attorneys who have access to Protected Information pursuant to this section shall not disclose such information except as provided in this subsection and in accordance with the provisions of the Texas Public Information Act (TPIA).
  - (A) If the commission receives from a member of the Texas Legislature a request for information that the commission has or has access to that is designated as "Protected Information" under the ERCOT Protocols, the commission shall provide the information to the requestor pursuant to the provisions of Texas Government Code Annotated §552.008. If permitted by the requesting member of the Texas Legislature the commission shall notify ERCOT, and, if applicable, the entity that provided the information to ERCOT, of the existence of the request, the identity of the requestor, and the substance of the request.
  - (B) If the commission receives a request for information that the commission has or has access to that has been designated as Protected Information under the Protocols the commission shall make a good faith effort to provide notice of the request to the affected market participant and

ERCOT within three business days of receipt of the request. If the third-party provider of the information objects to the release of the information, the commission shall offer to facilitate an informal resolution between the requestor and the third party. If informal resolution of an information request is not possible, the commission will process the request in accordance with the TPIA.

- (C) In the absence of a request for information, if the commission staff seeks to release information that the commission has or has access to that has been designated as Protected Information under the Protocols, the commission may determine the validity of the asserted claim of confidentiality through a contested-case proceeding. In a contested case proceeding conducted by the commission pursuant to this subsection, the staff, the entity that provided the information to the commission, and ERCOT will have an opportunity to present information or comment to the commission on whether the information is subject to protection from disclosure under the TPIA.
- (D) In connection with any challenge to the confidentiality of information under subparagraph (C) of this paragraph, any person who asserts a claim of confidentiality with respect to the information must, at a minimum, state in writing the specific reasons why the information is subject to protection from public disclosure and provide legal authority in support of such assertion.

- (E) Except as otherwise provided in subparagraph (A) of this paragraph, if either the commission or the attorney general determines that the disclosure of information designated as Protected Information under the ERCOT Protocols is appropriate, the commission shall provide notice to the entity that provided the information and to ERCOT at least three business days prior to the disclosure of the Protected Information (or, in the case of a valid and enforceable order of a state or federal court of competent jurisdiction specifically requiring disclosure of Protected Information earlier than within three business days, prior to such disclosure).
- (f) **Conflicts of interest.** ERCOT shall adopt policies to ensure that its operations are not affected by conflicts of interests relating to its employees' outside employment and financial interests and its contractors' relationships with other businesses. These policies shall include an obligation to protect confidential information obtained by virtue of employment or a business relationship with ERCOT.
- (g) **Qualifications for membership on governing board.** ERCOT shall establish and implement criteria for an individual to serve as a member of its governing board, procedures to determine whether an individual meets these criteria, and procedures for removal of an individual from service if the individual ceases to meet the criteria.
- (1) The qualification criteria shall include:

- (A) Definitions of the market sectors;
  - (B) Levels of activity in the electricity business in the ERCOT region that an organization in a market sector must meet, in order for a representative of the organization to serve as a member of the governing board;
  - (C) Standards of good standing that an organization must meet, in order for a representative of the organization to serve as a member of the governing board; and
  - (D) Standards of good standing that an individual must meet, in order for the individual to serve as a member of the governing board.
- (2) The procedures for removal of a member from service on the governing board shall include:
- (A) Procedures for determining whether an organization or individual meets the criteria adopted under paragraph (1) of this subsection; and
  - (B) Procedures for the removal of an individual from the governing board if the individual or the organization that the individual represents no longer meets the criteria adopted under paragraph (1) of this subsection.
- (3) The procedures adopted under paragraph (2) of this subsection shall:
- (A) Permit any interested party to present information that relates to whether an individual or organization meets the criteria specified in paragraph (1) of this subsection; and
  - (B) Specify how decisions concerning the qualification of an individual will be made.



- (4) A decision concerning an individual or organization's qualification is subject to review by the commission.
  
- (h) **Required reports.** Beginning with the 2002 calendar year, ERCOT shall file an annual report with the commission, not later than 120 days after the end of the year.
  - (1) The annual report shall include:
    - (A) An independent audit of ERCOT's financial statements for the report year;
    - (B) A schedule comparing actual revenues and costs to budgeted revenues and costs for the report year and a schedule showing the variance between actual and budgeted revenues and costs;
    - (C) An independent audit of ERCOT's market operation for the report year;  
and
    - (D) The annual board-approved budget.
  - (2) ERCOT shall file quarterly reports no later than 45 days after the end of each quarter, which shall include:
    - (A) All internal audit reports that were produced during the reporting quarter;  
and
    - (B) A report on performance measures, as prescribed by the commission.
  
- (i) **Compliance with rules or orders.** ERCOT shall inform the commission with as much advance notice as is practical if ERCOT realizes that it will not be able to comply with PURA, the commission's substantive rules, or a commission order. If ERCOT fails to

comply with PURA, the commission's substantive rules, or a commission order, the commission may, after notice and opportunity for hearing, adopt the measures specified in this subsection or such other measures as it determines are appropriate.

- (1) The commission may require ERCOT to submit, for commission approval, a proposal that details the actions ERCOT will undertake to remedy the non-compliance.
- (2) The commission may require ERCOT to begin submitting reports, in a form and at a frequency determined by the commission, that demonstrate ERCOT's current performance in the areas of non-compliance.
- (3) The commission may require ERCOT to undergo an audit performed by an appropriate independent third party.
- (4) The commission may assess administrative penalties under PURA Chapter 15, Subchapter B.
- (5) The commission may suspend or revoke ERCOT's certification under PURA §39.151(c) or deny a request for change in the terms associated with such certification.
- (6) The imposition of one penalty under this section does not preclude the imposition of other penalties as appropriate for the instance of non-compliance or related instances of non-compliance.
- (7) In assessing penalties, the commission shall consider the following factors:
  - (A) Any prior history of non-compliance;
  - (B) Any efforts to comply with and to enforce the commission's rules;

- (C) The nature and degree of economic benefit or harm to any market participant or electric customer;
  - (D) The damages or potential damages resulting from the instance of non-compliance or related instances of non-compliance;
  - (E) The likelihood that the penalty will deter future non-compliance; and
  - (F) Such other factors deemed appropriate and material to the particular circumstances of the instance of non-compliance or related instances of non-compliance.
- (8) The commission may initiate a compliance proceeding or other enforcement proceeding upon its own initiative or after a complaint has been filed with the commission that alleges that the ERCOT has failed to comply with PURA, the commission's substantive rules, or a commission order.
- (9) Nothing in this section shall preclude any form of civil relief that may be available under federal or state law.
- (j) **Priority of commission rules.** This section supersedes any protocols or procedures adopted by ERCOT that conflict with the provisions of this section. The adoption of this section does not affect the validity of any rule or procedure adopted or any action taken by ERCOT prior to the adoption of this section.

This agency hereby certifies that the rules, as adopted, have been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §25.361, relating to Electric Reliability Council of Texas (ERCOT), and §25.362, relating to Electric Reliability Council of Texas (ERCOT) Governance, are hereby adopted with changes to the text as proposed.

**ISSUED IN AUSTIN, TEXAS ON THE 5th DAY OF MARCH 2003.**

**PUBLIC UTILITY COMMISSION OF TEXAS**

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**Rebecca Klein, Chairman**

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**Brett A. Perlman, Commissioner**

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**Julie Caruthers Parsley, Commissioner**