

SUBJECT: Oversight and regulation of the Electric Reliability Council of Texas

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 7 ayes — P. King, Hunter, Baxter, R. Cook, Crabb, Hartnett, Turner
0 nays

SENATE VOTE: On final passage, April 14 — 31-0

WITNESSES: For — John Fainter, Association of Electric Companies of Texas, Inc.; Kay Trostle, Structural Metals, Inc., TXI-Chaparral Steel, Nucor Steel; (*Registered, but did not testify:* Michael Jewell, Direct Energy, CPL Retail Energy, WTU Retail Energy; Phillip Oldham, Texas Coalition for Competitive Electricity; Mark Zion, Texas Public Power Association

Against — None

On — Carol Biedrzycki, Texas Ratepayers Organization to Save Energy; Thomas Schrader, ERCOT

BACKGROUND: The Electric Reliability Council of Texas (ERCOT) is one of 10 regional reliability councils in North America and the Independent System Operator for the ERCOT area. The organization serves 7 million electricity customers and oversees the operation of more than 78,000 megawatts of generation and 37,500 miles of transmission lines in the state. ERCOT serves about 85 percent of the state's demand for electricity and 75 percent of the geographic land area of the state. While most of Texas is in the ERCOT region, portions of the Panhandle, far West Texas, Northeast Texas, and Southeast Texas are in the other adjacent power regions.

ERCOT is responsible for facilitating wholesale electricity transactions among power generators and retailers, ensuring customer information is provided to retailers, maintaining the reliability of the transmission network, and ensuring open access to the network.

ERCOT is governed by a 14-member board of directors that includes

representatives of electric market segments, consumers, unaffiliated members, and ex officio members.

DIGEST:

CSSB 743 would grant the Public Utility Commission (PUC) the authority to oversee, approve, and order modifications of any part of the finances, budget, or administration of ERCOT. ERCOT would be accountable directly to the PUC. ERCOT would be required fully to cooperate with the PUC in the commission's oversight and investigatory functions. The PUC could decertify ERCOT if it did not comply with its duties under the bill.

ERCOT would have to provide the PUC with information to allow the commission to review ERCOT's budget for efficiency and necessity of budget items. The PUC would review the salaries, employee benefits, and debt of ERCOT.

After determining ERCOT's budget to be reasonable, the PUC could authorize ERCOT to charge wholesale buyers and sellers of electricity a competitively neutral rate set by the commission. This rate would allow ERCOT to take in an amount of revenue determined by the commission. ERCOT could change this rate only with PUC approval. The commission could inquire into the reasonableness of ERCOT's budget or rate after receiving a complaint.

ERCOT's governing body. ERCOT's governing body would have 16 members, including:

- the PUC chairman as an ex officio nonvoting member;
- the Office of Public Utility Counsel (OPUC) counselor as an ex officio voting member representing residential and small commercial consumer interests;
- the chief executive officer of ERCOT as an ex officio voting member;
- six market participants elected by their market segments to serve one-year terms, with one member each representing independent generators, investor-owned utilities, power marketers, retail electric providers, municipally owned utilities, and electric cooperatives;
- a representative of industrial consumer interests, elected by this market segment to serve a one-year term;
- a representative of large commercial consumer interests selected by the outgoing large commercial consumer representative to serve a one-year term; and

- five representatives unaffiliated with any market segment selected by the other members of the governing body to serve three-year terms.

One of the five unaffiliated representatives would serve as presiding officer of ERCOT's governing body.

Violations by market participants. Any person who participated in a market overseen by ERCOT would observe all scheduling, operating, planning, reliability, and settlement guidelines established by ERCOT. A violation by any person of those rules could result in the revocation of that person's registration or in an administrative penalty. The PUC could require the refunding or disgorgement of unjust profits that accrued in violation of the bill.

Open meeting requirements. The ERCOT governing body and its members would be subject to state open meeting laws in the same way those laws apply to a governmental body. However, requirements in ERCOT's bylaws pertaining to executive sessions, advance notice of meetings and agendas, and public comment on items discussed in meetings would apply in lieu of conflicting state laws.

ERCOT's bylaws and PUC rules would allow the ERCOT governing body or a subcommittee to enter into a closed executive session to address sensitive matters. The bylaws and rules also would ensure that a person interested in the organization's activities could obtain at least seven days' notice of meetings of the governing body and the planned agenda. An addendum to the agenda could be posted at least two hours before the meeting if the notice identified an emergency or public necessity for the addendum.

Conflicts of interest. If a member of the ERCOT governing body had a direct interest in a matter before the body, the member would have to disclose that interest and recuse himself or herself from deliberations and votes on the matter. Such a recusal would not affect a quorum.

Market monitor. ERCOT would contract with a private person selected by the PUC to act as the wholesale electric market monitor to detect market power abuses. ERCOT would pay the monitor through its authorized rate and allow the monitor to use the organization's main operations center.

ERCOT would ensure that the monitor had the resources available to monitor the wholesale electric market effectively.

The monitor would operate under the supervision of the PUC. The PUC would define:

- the monitor's responsibilities;
- funding and staff levels for the monitor;
- qualifications for staff;
- ethical standards for the monitor;
- procedures for communication among the monitor, the PUC, and ERCOT;
- the reporting requirements of the monitor; and
- confidentiality requirements.

The PUC would consult with a subcommittee of the ERCOT board to determine funding for the monitor. The monitor would have to be independent from market participants.

The monitor would report any market power abuses or violations of PUC or ERCOT to the PUC and to a market participant who was the subject of the report. The monitor would submit an annual report to the PUC and ERCOT identifying market design flaws, which the PUC and ERCOT would use to evaluate whether rule changes should be made.

Effective date. ERCOT would have to modify its governing body no later than January 1, 2006. The bill would take effect September 1, 2005

**SUPPORTERS
SAY:**

CSSB 743 would institute much needed oversight and accountability reforms for ERCOT and its board of directors. ERCOT has been the target of serious allegations of mismanagement and wasteful spending, and several former employees and contractors have been indicted for felony charges related to contracting fraud. Due to ambiguity surrounding the applicability of state open meetings and public records laws, members of the public have been stymied in their attempts to learn more about ERCOT's business practices and participate in its decision-making process. ERCOT performs vital functions in its management of the state's electric market, and it is imperative that this powerful organization be accountable to the public it serves.

By explicitly requiring that state open meetings and public records laws apply to ERCOT, CSSB 743 would help ensure public confidence in the operations of this important organization. The PUC would gain the authority to review ERCOT's budget, and the commission would authorize fees for ERCOT only after approval of its budget. In addition, the bill explicitly would require board members to recuse themselves when conflicts of interest arose. ERCOT is funded by fees paid by millions of electric customers in Texas, and the public deserves to know that these funds are being spent appropriately.

CSSB 743 would improve the representativeness of the ERCOT board by increasing the number of independent members from three to five. As ERCOT has become a more public entity, it has become important to have independent, non-market representation on its governing board. Having five independent members in addition to the bill's strong conflict-of-interest provisions would allow for the public interest effectively to be served by the board.

The adoption of an independent market monitor would enable the PUC to identify and sanction any abuses of market power that occurred within ERCOT. Large wholesale generators have the capacity to manipulate the market and control prices, and it is important that an independent entity exists to ensure that such abuses do not occur. The bill would authorize the PUC to require refunds and disgorgement of any unjust profits realized through the abuse of market power. Such powers are necessary because profits resulting from large-scale manipulations easily could dwarf the penalty authority the PUC has over those market participants.

OPPONENTS
SAY:

Although the bill would increase the number of independent members on ERCOT, consumer representation on the board would remain weak. Consumers pay the fees through which ERCOT is funded, and they deserve a strong voice to ensure that these funds are spent prudently. Market participants would continue to outnumber residential, industrial, and commercial consumers. The Sunset Commission found that industry representatives on the ERCOT board have little incentive to act in the best interest of consumers, and increasing public representation could address this imbalance.

There is no compelling reason for the representative of large commercial consumer interests to be appointed by the outgoing commercial representative rather than elected from that market segment. When this

position on the ERCOT board was created, this market segment was not large enough to allow for an election of that representative. However, many large commercial interests now participate in the electric market, and these participants should be able to elect their representative as other market segments do.

OTHER
OPPONENTS
SAY:

While CSSB 743 would strengthen protections against wholesale generation market manipulation, additional reforms are needed. Market manipulation can be difficult to identify after an abuse has occurred. A more effective method of preventing abusive practices by wholesale generators would be to require that no company control more than 20 percent of the generation capacity in a single congestion area, rather than the current, more general limitation of 20 percent across the entire ERCOT region.

NOTES:

As passed by the Senate, SB 743 would have given the PUC general power to regulate ERCOT and do anything necessary to exercise that power. The bill specifically would have designated the types of oversight the PUC could perform, such as audits, inspections, assessment of penalties, and dispute resolution. The bill would have required that the members of the ERCOT governing body be selected in accordance with formal bylaws approved by the PUC. The committee substitute added provisions that would allow ERCOT to enter into a closed executive session or convene a meeting without advance notice in the event of an emergency.

According to the LBB, CSSB 743 would result in a cost of \$3 million from the System Benefit Fund to fund the bill's market monitor provisions.

HB 1777 by P. King, which contains provisions on ERCOT similar to those in CSSB 743, passed the House on May 5 and has been referred to the Senate Business and Commerce Committee.