

# Electric Reliability Council of Texas

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## Agency at a Glance

The Electric Reliability Council of Texas (ERCOT) manages the electric grid for most of Texas, ensuring the reliable delivery of electricity by coordinating the flow of power on and off the grid. The ERCOT region in Texas accounts for 85 percent of Texas' electric consumption and 75 percent of the Texas land area. In the last 15 years, the Legislature has restructured the generation and retail sale of electricity in the ERCOT region to be competitive.

Because Texas' electric grid is not directly connected to grids in other states, ERCOT is primarily regulated by the Public Utility Commission (PUC), not federal authorities. ERCOT is managed by a Board of Directors as a nonprofit corporation and carries out the following key duties.

- Ensures reliability by directing the transmission of electricity by scheduling power through a grid that connects 550 generation units to 22 million Texans through 40,000 miles of transmission lines.
- Settles financial transactions among electric market participants using the detailed information it maintains about participants' production and consumption of electricity.
- Operates a wholesale power market to meet power needs of retail electric providers not covered through established agreements between such providers and generators.
- Records in its databases when consumers in competitive retail areas switch retail electric providers.

## Summary

State law and PUC action have transformed ERCOT into a much more important participant in the Texas electric marketplace from its conception by Texas' electric utilities to manage transmission of electricity between service areas. ERCOT is the Independent System Operator in Texas' restructured electric market, a role that gives it responsibility to ensure the reliable delivery of electricity, oversee the electric grid, and operate the wholesale marketplace for electricity. ERCOT plays a large and important role in the health and safety of Texans by ensuring the reliable transmission of electricity. Since electric market restructuring and the break-up of monopoly electric companies, ERCOT has assumed the important economic role of operating key components of the wholesale electric market for much of Texas.

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Because of its importance in the lives of Texans, ERCOT needs more accountability and objectivity in how it operates. Although ERCOT derives its authority as an independent system operator from statute and is regulated by PUC, it lacks the ongoing legislative and financial oversight needed to ensure accountability for its important responsibilities. In addition, ERCOT's Board and advisory committee structure do not provide needed objectivity for conducting ERCOT's business.

## Issue 1

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### ***The Electric Reliability Council of Texas Needs Better Oversight to Address High Risk in Its Operations.***

In performing its job of ensuring the reliable distribution of electricity and coordinating the operation of the competitive electric market, ERCOT spent \$267 million in 2010 in funds derived from statutorily permitted charges on electricity. Because of ERCOT's public purposes, PUC oversees ERCOT's collection of fee revenue.

Oversight of an entity like ERCOT needs to be scaled to the risk and public importance of its functions. However, PUC's oversight of ERCOT is incomplete, given this level of risk. PUC only reviews requests for increases in ERCOT's fee authority and does not review spending in years in which ERCOT does not request an increase. In fact, PUC has not reviewed ERCOT's budget since 2006, over which time its operating expenses have increased 62 percent. PUC also does not review ERCOT's use of debt financing, an important point given ERCOT's accumulated debt of \$365 million. As a public-purpose, nonprofit corporation, ERCOT also does not receive routine legislative oversight. Although the corporation is under Sunset review this legislative cycle, the Sunset review is a one-time requirement.

## **Recommendations**

### ***Change in Statute***

#### **1.1 Require PUC to exercise additional oversight authority of the Electric Reliability Council of Texas by:**

- annual review and approval of ERCOT's entire budget;
- prior review and approval of all uses of debt financing; and
- annual review of PUC-approved performance measures tracking ERCOT's operations.

Statute would require PUC to take an active role in reviewing ERCOT's spending by focusing on the agency's entire budget, not just requests for additional fee authority. The statute would require PUC to review and approve ERCOT's budget annually, with the explicit authority to approve, disapprove, or modify each item in ERCOT's budget. These reviews would be exempt from requirements to conduct proceedings as a contested case and PUC would be granted authority to determine the most appropriate process for allowing public participation in conducting the reviews. PUC would be granted rulemaking authority to establish reasonable dates for submission of all necessary budget documents and the necessary level of detail contained within the documents. Statute also would require PUC to review and approve each request for use of debt funding or refinancing of existing debt.

Statute would require ERCOT to develop measures for tracking its performance. PUC would approve these measures and review the organization's performance as part of the budget review process. PUC

would report these measures annually to the substantive committees of the Legislature that oversee electric utility regulation, Speaker of the House, and the Lieutenant Governor.

**1.2 Establish that the System Administration Fee vary according to the revenues needed to fund the budget approved by PUC, and require reporting by ERCOT to ensure that budget projections are met.**

PUC would approve the appropriate level of funding for ERCOT's annual budget. ERCOT would then set the System Administration Fee, within a range set by PUC, to raise the projected amount of budgeted funds. The ERCOT Board would adjust the fee on a quarterly basis as more accurate information is known about the revenues that the fee is actually producing. To ensure that ERCOT closely matches the fee to the budget to avoid ending a year with extra or inadequate funds, ERCOT would submit quarterly reports to PUC comparing actual expenditures with budgeted amounts.

**1.3 Create a Sunset clause providing for future Sunset reviews of ERCOT, concurrent with reviews of the Public Utility Commission.**

This recommendation would require the Sunset Commission to review ERCOT, but would not include an automatic termination clause. Future Sunset reviews would occur in the same legislative cycle that the Commission reviews PUC. As a public-purpose, nonprofit corporation not receiving state appropriations, ERCOT would continue to pay the cost of its Sunset reviews.

## Issue 2

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***The Dominance of Electric Market Stakeholders on the ERCOT Board Potentially Reduces its Objectivity.***

The Legislature has restructured ERCOT from an industry group that managed the exchange of power among monopoly electric companies into a public-purpose agency. Today ERCOT serves as Texas' Independent System Operator, a role that gives it responsibility to ensure reliable transmission of electricity and to operate the electric market. ERCOT is governed by a 16-member Board of Directors composed of directors, a large majority of whom represent stakeholders in the electric market, as well as directors who are unaffiliated with the market, having no financial stake in its operation, as shown in the chart on the following page.

Although the Board makes critical decisions affecting Texas' \$34 billion competitive electric market, industry stakeholders with direct and significant financial interests in these decisions hold eight of 15 votes (the PUC Chair is a non-voting member). ERCOT is unique as being the only transmission system operator in North America structured in this manner.

Most issues going to the ERCOT Board begin with discussions in ERCOT's Technical Advisory Committee. This committee is composed of 30 stakeholders primarily representing industry interests, and essentially guides the process for revising policies and protocols, which are requests to change the rules and procedures governing market operations. The committee's role as a frequent initiator of protocol and policy changes does not follow the advisory committee pattern typically seen in state agencies in which advisory committees assist boards that initiate policy changes and staff that develops them.

**ERCOT Board of Directors**

16 Total Members	Represents	Method of Selection	Term
8 Electric Market Stakeholders	Electric cooperatives	Elected by respective market segment	1 Year
	Independent generators		
	Independent power marketers		
	Investor-owned utilities		
	Municipally owned utilities		
	Retail electric providers		
	Industrial consumers		
	Large commercial consumers		
5 Unaffiliated Directors	Unaffiliated with any market segment	ERCOT Membership	3 Years
PUC Chair (non-voting)	Public Utility Commission	Ex Officio	N/A
ERCOT CEO	ERCOT	Ex Officio	N/A
Public Counsel of the Office of Public Utility Counsel	Residential and small commercial consumers	Ex Officio	N/A

**Recommendations**

***Change in Statute***

**2.1 Change the makeup of the ERCOT Board of Directors to promote greater objectivity and financial expertise.**

Under this recommendation, the ERCOT Board would be increased from 16 to 17 members, adding representation by unaffiliated members and changing the ex officio representation by PUC and the Office of Public Utility Counsel (OPUC). Specifically the Board structure would be changed as follows.

- Increase the number of directors unaffiliated with the electric market from five to six, and require that one of these directors have financial expertise.
- Replace the PUC Chair with a PUC-appointed unaffiliated, voting member who is either a former PUC Commissioner or another appropriate appointment selected by PUC.
- Replace the Public Utility Counsel with a voting member appointed by OPUC to represent residential and small commercial consumers.

Under this recommendation, the existing eight positions for electric market stakeholders would be retained, as would the position for the ERCOT Chief Executive Officer as an ex officio voting member.

With the change, the ERCOT Board would have seven unaffiliated members, eight electric market stakeholders, one representative of residential and small commercial consumers, and the ERCOT Chief Executive Officer. The effect of the change is to better balance the interests of the electric market stakeholders currently on the Board to improve objectivity in its decision making without sacrificing expertise.

## **2.2 Revise ERCOT's protocol process to have the ERCOT Board of Directors drive protocol development and revisions.**

This recommendation would require the newly structured ERCOT Board to initiate new policies or revisions to policies. Staff would develop these new or revised policies for Board approval. The ERCOT Board would be charged by statute with developing a new representative advisory committee structure to provide technical support, and not drive, Board initiatives or staff work. This structure would be reflected in ERCOT bylaws and subject to PUC approval.

## **Fiscal Implication Summary**

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Issue 2 has a fiscal impact but would not result in an additional cost to the State.

- **Issue 2** – Requirements to add an ERCOT-appointed unaffiliated director, a PUC-appointed unaffiliated director, and a director appointed by the Public Utility Counsel would increase ERCOT costs up to \$270,000 for the new directors' salaries. This cost would be borne by the System Administration Fee and not a state fund.

