

Pros and Cons of Texas RE Performing ERCOT Protocol and Operating Guide Compliance

By request of the Texas Reliability Entity (“Texas RE”) Board, the Texas RE Member Representatives Committee has prepared this brief position paper that identifies the pros and cons of having Texas RE perform Electric Reliability Council of Texas (“ERCOT”) Protocol and Operating Guide compliance post December 31, 2010.

Introduction

Purpose of Texas Reliability Entity

Subtitle A of the Electricity Modernization Act of 2005 added Section 215 to the Federal Power Act (16 U.S.C. § 824n) to specifically authorize uniform federal oversight of the reliability of the bulk electric system (hereafter referred to as “Section 215”). Section 215(e)(4) of the Federal Power Act (“FPA”) grants the Federal Energy Regulatory Commission (“FERC”) authority to adopt rules authorizing the North American Electric Reliability Corporation (“NERC”) to enter into an agreement to delegate authority to a regional entity for the purpose of proposing reliability standards to NERC and enforcing reliability standards, and FERC did so. Chapter I, Title 18, Code of Federal Regulations, Part 39, as adopted by Commission in Order No. 672 in Docket No. RM05-30-000 on February 3, 2006; (114 FERC ¶ 61, 104). Specific provisions govern the approval of a delegation agreement between NERC and a regional entity. 18 C.F.R. § 39.8.

NERC and FERC have granted Texas RE the authority to perform “Non-Statutory Activities” through December 31, 2010 via the Amended Delegate agreement (Exhibit E, 5. Description of Non-Statutory Activities). “Non-Statutory” activities are defined as investigation of market participants’ compliance with the ERCOT Protocols and Operating Guides so long as the ERCOT Compliance activities do not conflict with the “Statutory” activities defined by NERC rules of procedure (Exhibit E, 1. Scope of activities funded through the ERO funding mechanism).

The enabling statute and rules promulgated by FERC specify the means by which the Electric Reliability Organization, which is NERC may delegate its authority to one or more Regional Reliability Organizations and the means by which funding and oversight will occur. The rules further specify that Texas RE may, subject to those operating guidelines and oversight, engage in tasks that are outside the scope of the Section 215 responsibilities.

Current Protocol and Operating Guide Compliance Monitoring Agreement

Texas RE, the Public Utility Commission of Texas (“PUC”), and ERCOT entered into a Statement of Work No. 1 Under Tri-Party Professional Services Agreement effective July 1, 2010 (“July 2010 SOW”) to define the roles and responsibilities of each party to ensure compliance with reliability-related provisions of the ERCOT Protocols, ERCOT Operating Guides, PUC Substantive Rules, and PUC enabling legislation (defined by the July 2010 SOW as “the Legal Requirements” and interchangeably referred to here generally as “the ERCOT Rules”). The Statement of Work requires Texas RE to be knowledgeable of the Legal Requirements and to maintain sufficient staff to carry out the services specified in the agreement. If Texas RE does not meet these requirements, it will be in violation of the agreement. The PUC may periodically review the performance of Texas RE and is authorized to terminate the agreement with 30 days notice. The SOW expires at the end of 2010.

The Legal Requirements are imposed pursuant to state law and are separate and apart from the obligations imposed pursuant to Section 215, though they may be similar to, and cannot be inconsistent with, the obligations imposed by Section 215. Texas RE acts as the Reliability Monitor regarding ERCOT and market participant compliance with the Legal Requirements, reporting to the PUC. The PUC enforces the Legal Requirements, including prosecution as necessary. Texas RE and the PUC rely on information and expertise provided by ERCOT in evaluating compliance as detailed in Section II of the July 2010 SOW.

New Delegation Agreement

FERC has recently approved a new Delegation Agreement between NERC and Texas RE. This approval supersedes the previous FERC-approved delegation agreement between NERC and Texas Regional Entity (“old Texas RE”), which entity was a division of ERCOT. Unlike the original delegation agreement, the present Texas Reliability Entity, Inc. (Texas RE) is wholly independent of ERCOT and has its own bylaws. This independence was prompted

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by an audit of old Texas RE in which FERC expressed concern over old Texas RE's ability to monitor ERCOT's compliance with NERC and Regional Reliability Standards if the two entities were not, in fact, separate.

The new Delegation Agreement contains a statement in Exhibit E on funding that Texas RE may continue compliance monitoring of the ERCOT Rules as a non-statutory duty at least through the end of 2010. Exhibit E requires special accounting treatment for all non-statutory functions to separate the costs associated with those activities from its statutory functions.

PROS of Texas RE Performing Compliance Monitoring of the ERCOT Rules

P1: Similarity of Reliability Issues Subject to Federal and State Oversight

Compliance monitoring would be more efficient if performed by a single entity. Rather than having multiple entities overseeing market participant operations that are subject to both (federal) Reliability Standards and (state) Legal Requirements, a single entity such as Texas RE would facilitate communication, eliminate redundancy, reduce overall workload, and provide clarity for recommendations that benefit the reliability of the electric system. The ERCOT Rules that Texas RE would be asked to monitor deal directly with reliability of the bulk electric system. As such, these rules have an intimate relationship to FERC and NERC Standards regarding bulk electric system reliability. Having one group that understands the interplay between the NERC Standards and the ERCOT Rules places primary reliability monitoring responsibility in the hands of one entity, Texas RE. This is a benefit to market participants since audits and compliance activities will deal with only one entity. This is an advantage to Texas RE since they will have the comprehensive understanding of all reliability issues. This is a benefit to ERCOT as deferring to Texas RE will allow them to focus on operations and markets while having comfort that a competent organization is taking steps to assure compliance with the rules that deal with reliability.

P2: Single Event Investigation

Investigation of reliability events would be more efficient if performed by a single entity. Rather than having multiple entities investigating a reliability event that has implications in both the ERCOT Rules and the NERC Reliability Standards, a single entity such as Texas RE would facilitate communication, eliminate redundancy, reduce overall workload, and provide clarity for recommendations following the event.

P3: Compliance Monitoring is One of the Key Skill Sets of Texas RE

Texas RE possesses the necessary skills to perform compliance monitoring and gain the knowledge of the ERCOT Zonal Rules, and its familiarity with the market should facilitate its understanding of the ERCOT Nodal Rules. Indeed, the staff of Texas RE has been monitoring compliance with ERCOT for years. They have a thorough understanding of how ERCOT works.

P4: Compliance Audit

The audits for NERC Standards and ERCOT Rules are currently scheduled for the same week and are conducted by the same Texas RE audit team. This consistency and economy has worked well. The audit burden for registered entities will substantially increase if these functions are separated. For example, if the ERCOT Rules audits are contracted separately, entities can expect audits at different times, with different auditors, whose task is to review similar evidence of compliance. This also increases the possibility that the two groups of auditors will obtain different conclusions regarding a similar rule.

P5: Comity between Federal and State Governments

The PUC has not requested that Texas RE perform Compliance Monitoring of the ERCOT Rules after December 31, 2010. However, if they chose to do so, then Texas RE would naturally wish to be responsive to a request from the PUC to perform this function should Texas RE determine that the request is not in conflict with or detrimental to achieving its core statutory obligations.

CONS of Texas RE Performing Compliance Monitoring of the ERCOT Rules

C1: Texas RE Need Not Engage in Non-Statutory Functions

FERC and NERC oversight of Texas RE specify that Texas RE cannot be required to engage in non-statutory functions and that it is permitted to do so only under certain circumstances. Texas RE recently completed a legal separation from ERCOT to assure FERC and NERC of its independence. Texas RE should consider whether a continuing engagement in non-statutory compliance monitoring will foster or diminish the perception of independence.

There is a burden imposed by the financial and workload accounting required to separate statutory and non-statutory functions as they are carried out on a daily basis. Allocation formulas are viewed with suspicion and specific timekeeping and cost allocation requires constant commitment by all employees. FERC and NERC, as well as the PUC, will expect full attention to their respective priorities. Texas RE must determine whether public and institutional benefits of undertaking non-statutory functions continue to outweigh the burdens.

C2: Texas RE Has No Independent Knowledge of Reliability Events

Texas RE is dependent upon ERCOT, principally, and the market participants, to a far lesser extent, for all information it obtains regarding all reliability events and occurrences of non-compliance. Unlike the ERCOT Independent Market Monitor, Texas RE has no data warehouse, and it is unclear whether Texas RE can have regular ongoing access to ERCOT information due to NERC Critical Infrastructure Protection requirements. In other words, Texas RE can see only what ERCOT shows it. This creates a hardship on Texas RE, which is driven to ask for as much information as possible, in order not to miss a key piece of data, and creates a corresponding hardship on ERCOT, which must respond to substantial Texas RE requests. This situation is more serious for the Legal Requirements than for Reliability Standards, because of the volume and particularity of the Legal Requirements.

NERC standards contain very specific elements that include requirements, measurements, and levels of compliance necessary to ensure uniformity of regional standards. ERCOT Rules do not provide the same format and require continuous monitoring of network operations and market activities.

C3: Requires Developing a Comprehensive Understanding of the ERCOT Nodal Rules

The ERCOT Nodal Rules are expected to go into effect on December 1, 2010. Texas RE, or any other entity overseeing compliance with the ERCOT Rules except perhaps the current Independent Market Monitor, must overcome a steep learning curve of both theory and practice after the Nodal Rules take effect.

C4: Texas RE Enforcement of ERCOT Rules May Affect the Jurisdiction Status Quo

Except for ERCOT, the U.S. electricity wholesale markets are subject to FERC jurisdiction. The ERCOT electricity wholesale market is subject to PUC jurisdiction. The jurisdictional distinction of wholesale electricity in ERCOT is subject to continuous refinement by FERC and the PUC. Texas RE currently is the only regulatory or quasi-regulatory entity tasked with enforcing separate state and federal regulatory regimes in ERCOT. The dual-compliance role Texas RE undertakes carries the risk of creating new and unforeseen jurisdictional friction.

C5: Funding and Accounting Challenges

Continuing to perform non-statutory functions could continue to subject Texas RE to additional scrutiny by NERC and FERC auditors. As has been the ongoing processes at Texas RE, "Statutory" and "Non-Statutory" expenses will continue to be accounted for separately and that "Non-Statutory" expenses will not be included in Texas RE dues, fees, and other Texas RE charges. "Non-Statutory" activity expenses are funded through the state approved ERCOT administration fee. Texas RE is responsible to organize itself and budget for staffing needed to meet "Statutory" requirements.