

APPROVED MINUTES OF THE ERCOT BOARD OF DIRECTORS MEETING

Electric Reliability Council of Texas, Inc. Offices

Austin, TX

10:00 a.m.

March 16, 2004

Pursuant to notice duly given, the Meeting of the Board of Directors of Electric Reliability Council of Texas, Inc. convened at approximately 10:15 a.m. on March 16, 2004.

Meeting Attendance:

Board members:

Armentrout, Mark		Unaffiliated
Baggett, David		Unaffiliated
Espinosa, Miguel		Unaffiliated
Greene, Mike	Oncor Electric Delivery Company	IOU - ERCOT Chairman; left at 11:15
Huddleston, Barry	Dynegy Power Corp.	Independent Generator
Hudson, Paul	Public Utility Commission of Texas	PUCT Chairman
Kahn, Bob	Austin Energy	Municipal
Karnei, Clifton	Brazos Electric Coop	Cooperative
Manning, Bob	H-E-B Grocery Company	Consumer/ Commercial – ERCOT Vice Chairman; proxy for Tom Noel, CEO; and proxy for Mike Greene after 11:15 a.m.
Ogleman, Kenan	Office of Public Utility Counsel	Consumer/OPUC/Residential; proxy for Suzi McClellan
Payton, Tom	Occidental Chemical Corp.	Consumer/Industrial
Stockstill, Dottie	Mirant Americas E.M.	Independent PM
Veiseh, David	Utility Choice Electric	Independent REP

ERCOT Staff and Guests:

Maxine Buckles	ERCOT Staff – VP and CFO
Margaret Pemberton	ERCOT Staff – VP, General Counsel and Corporate Secretary
Sam Jones	ERCOT Staff – Executive VP and COO
Ken Shoquist	ERCOT Staff – VP and CIO
Ray Giuliani	ERCOT Staff – VP and Chief of Market Operations
Beth Garza	FPL Energy – TAC Chairman
John Meyer	Reliant Resources Inc.
Parviz Adib	PUCT
Valerie Anderson	GDS Associates
Vikki Gates Cuddy	Structure
Herny Duwasachtor	TXU
Bob Helton	ANP
David Itz	Calpine
Jim Krajecki	Structure
Dan Madru	Senate Business & Commerce Committee
John Moore	
Steven Moss	First Choice Power
Adrian Pieniazek	CenterPoint Energy

Greg Ramon	TECO Energy
David Ranucci	Lodestar
Walt Shumate	Shumate & Associates
Kay Trostle	TXI
Jim Harder	Garland Power & Light
Wendell Bell	TPPA
Hal Hughes	R.J. Covington Consulting
David Kidd	AEP
Paul Hassink	AEP
Neil Eddleman	TEAM (Texas Energy Assoc. for Marketers)
Henry Vadie	Utility Choice Electric
Denise Stokes	Competitive Assets
Garry Waters	Competitive Assets
Mark Dreyfus	Austin Energy
Marialyn Barnard	CPS
Steve Bartley	CPS
Phillip Oldham	TIEC
Jim Galvin	ERCOT Staff
Shari Heino	ERCOT Staff
Carrie Morgan	ERCOT Staff
Mark Walker	ERCOT Staff
David Kasper	ERCOT Staff
Betty Day	ERCOT Staff
Trip Doggett	ERCOT Consultant/TNT Facilitator
Gary Stroud	ERCOT Staff
Lacy Seybold	ERCOT Staff
Steve Wallace	ERCOT Staff
Dan Woodfin	ERCOT Staff
Ken Donohoo	ERCOT Staff
Susan Vincent	ERCOT Staff
Richard Gruber	ERCOT Staff
Cheryl Yager	ERCOT Staff
Heather Tindall	ERCOT Staff

Announcements

Chairman Mike Greene called the meeting to order and determined that a quorum was present. He noted that Tom Noel was absent because he was on vacation with his family. He also recognized Mr. Paul Hudson, Chairman of the PUCT. Chairman Greene recognized Kenan Ogleman who was serving as proxy for Suzi McClellan and noted that Bob Manning was serving as proxy for Tom Noel.

Approval of Minutes

Chairman Greene requested comments on and approval of the minutes of the February 2004 meeting. **David Baggett moved to approve the February meeting minutes. David Veiseh seconded the motion.** Commissioner Hudson stated that he was concerned that the minutes, as written, could be construed to imply that debt would be used as a replacement for fee revenue. He noted that he did not believe that the Reliability Counsel should rely on debt to replace fee revenue. Clifton Karnei replied that it was not the intent of the minutes that debt was a viable option, and indeed the Finance and Audit Committee did not consider debt a replacement for fee revenue. Mr. Karnei also noted that the Finance and Audit Committee would recommend offsetting the revenue reduction from the lowered fee by

decreasing spending, to be discussed later in the Board meeting. **The motion passed by a unanimous voice vote with no abstentions.**

Texas Nodal Team (TNT) Report

Chairman Greene invited Trip Doggett, the Independent Facilitator for the Texas Nodal project, to present the TNT Report. Mr. Doggett reported on the recent activities of the TNT.

Mr. Doggett stated that the Cost Benefit Study is underway and going well. Tabors Caramanis & Associates (“TCA”) was hired as consultants for the study. The TNT is developing and fine-tuning several change cases for submittal to TCA for a cost-benefit analysis in April. Mr. Doggett requested Board approval of language as follows:

A day-ahead market shall be established in ERCOT through the implementation of the Auction Day-Ahead model as soon as practicable but not later than March 2005 and the implementation of a day-ahead market that includes the settlement of CRRs in both real-time and day-ahead timeframes, and is substantially similar to the currently proposed Enhanced Hybrid Day-Ahead model no later than 12 months or as soon as practicable following the implementation of the real-time nodal market.

A lengthy discussion ensued regarding the feasibility of the March 2005 date considering credit and other unresolved issues.

Mr. Manning moved to approve language modified such that, in the 3rd line, it read, “hopefully not later than March 2005” (new text emphasized), which would make the March 2005 date more flexible but still a target. Ms. Stocksill seconded the motion. Mr. Baggett recommended a rewording of the language as follows.

A day-ahead market shall be established in ERCOT through the implementation of the Auction Day-Ahead model by March 2005 or as soon as practicable and the implementation of a day-ahead market that includes the settlement of CRRs in both real-time and day-ahead timeframes, and is substantially similar to the currently proposed Enhanced Hybrid Day-Ahead model within 12 months or as soon as practicable following the implementation of the real-time nodal market. (revised text emphasized)

Mr. Manning accepted the amendment and Ms. Stockstill seconded the amended motion. Kenan Ogleman noted that the Board, by approving the proposed language was not necessarily committing ERCOT to an advanced hybrid Day-Ahead Market. **The motion passed with twelve in favor and one opposed (Payton).**

Mr. Doggett then requested approval of the Texas Nodal Market Design Elements reflected in the following TNT-approved whitepapers: Congestion Management Concept Group Load Zones, Congestion Management Concept Group Congestion Management Concept Document, Market Operation Concept Group Market Components, Market Operation Concept Group Dynamic Load Ratings, and Market Operation Concept Group Day Ahead Ancillary Services.

Mr. Karnei moved to approve the design elements of the whitepapers and Mr. Kahn seconded the motion. Messrs. Ogleman and Veiseh recommended separating the motion so as to

present the first two whitepapers separately from the others. No revised motion was made. **The motion passed with ten in favor and three opposed (Veiseh, Ogleman and Payton)**

TAC Report

Beth Garza, TAC Chairman, reported on the most recent TAC meeting.

(1) Recent activities.

Ms. Garza reported that TAC endorsed RMR exit strategies for Laredo in a vote of 22-4-1; however, TAC remains concerned about the high cost of the San Miguel to Laredo 345kV line. In February, TAC approved revisions to the Operating Guides, adopted the Texas Retail Market Test Plan, formally chartered a Commercial Operations Working Group (COPS) with a sunset date of December 31, 2004, and appointed B.J. Flowers of TXU to serve as chairperson of the new working group. COPS will focus on current settlement and dispute processes.

(2) Protocol Revision Requests

Ms. Garza presented the following two PRRs for the Board's consideration:

- **PRR491:** This PRR separates the RPRS bid price used to resolve Local Congestion from that used to resolve Zonal Congestion and capacity insufficiency. Payments for capacity to resolve Local Congestion would be based on the Resource Category Generic Cost. For procurement of zonal or system capacity, payment would be based on the submitted RPRS bids. The PRR also removes the Market Solution concept. Impact analysis shows an impact to ERCOT computer systems (this is an additional requirement based on PRR413 and Project PR-30093 already in-flight). This PRR has no additional staffing, business function, or grid operations impacts. TAC recommended approval by a unanimous vote.
- **PRR493:** This PRR would revise a section within the Reactive Standards to clarify the mechanism an induction generator may use to receive an exemption from the VSS installed reactive capability requirements and the level of the payment. The impact analysis showed no impacts to ERCOT computer systems. 0.5 of an FTE will be required in transmission planning prior to implementation; an additional 0.10 FTE will also be needed in Compliance (can be absorbed by current staffing). This PRR has minor business process impacts and no grid operations impacts. TAC recommended approval by a unanimous vote.

After describing the PRRs, Ms. Garza invited questions and comments from the Board.

Mr. Veiseh asked if, because PRR493 does not identify a specific payment amount, the language would require additional action by the Board to set the amount of compensation. Ms. Garza explained that the Protocols provide for determination of payment by negotiations between the transmission provider and the generation owner directly. Mr. Payton noted that PRR493 provides an alternative to meet reactive requirements as opposed to providing an "exemption" for the induction generator. He noted that, as a practical matter, it would be better to refer to the PRR as providing an "alternative," not an "exemption". Ms. Garza explained that the reactive standards in the Protocols are intended to ensure that the reactive needs of an area are met regardless of the terminology employed in this PRR; PRR493 simply provides more flexibility in meeting those requirements.

Mr. Manning asked if PRR493 would have any staffing impacts. Ken Donohoo, ERCOT Manager of System Planning, explained that PRR493 would require an additional 0.5 FTE initially, but after the initial transition period, the net impact of 0.1 FTE would be absorbed by current staff resources.

Mr. Veiseh moved to approve both PRRs, and Mr. Baggett seconded the motion. The motion passed by unanimous voice vote with no abstentions.

All PRRs and supporting materials appear on the following ERCOT web page:
<http://www.ercot.com/AboutERCOT/PublicDisclosure/ProtocolRev.htm>

Grid Operations Update

Sam Jones, Executive Vice-President and COO, presented the Grid Operations Update. Mr. Jones noted that February was a quiet month for the operations group. Thunderstorms in North Texas caused the loss of an unusually large number of lines, including two critical lines. The system responded well and no bulk electricity problems resulted. A discussion ensued regarding how to compensate Resources Entities when they cannot produce power due to transmission outages. Mr. Huddleston noted that the Protocols address compensation in such situations.

Mr. Jones invited Mr. Bojorquez, Director of Transmission Services, to present a report on the RMR exit strategy for the Laredo generation units. Mr. Bojorquez noted that Laredo and Bates are the only RMR units in the ERCOT Region without an approved exit strategy. The overall magnitude of RMR contracts, based on the last twelve months of billing history, is approximately \$300,000,000, of which the uneconomic portion is estimated at \$137,000,000 (payments made for RMR service minus the value of the RMR energy generated which is uplifted to the market – positive “BENA offset”). The proposed exit strategy for the Laredo units resulted from an open process, which included input from CFE, the Mexican federal utility. A CFE/ERCOT joint study was released in October 2003 and finalized in December of that year. ERCOT staff recommendations were submitted at a meeting of the South Regional Planning Group, an ERCOT-led regional planning group, on February 19. TAC reviewed and endorsed those recommendations at its March 4, 2004 meeting.

The border area represents about 3,000 MW of demand that cannot be reliably met by existing transmission facilities under some circumstances. Flows into South Texas are generally from central Texas and subject to congestion mitigation due to excessive load on the transmission lines. Transmission lines in South Texas are also particularly vulnerable to losses that must be uplifted to the ERCOT Region market. Circumstances at the Lon Hill substation create a real risk of load shedding in the Valley. Other sources of power exist in the Laredo area; however, the closest resources are in Corpus Christi, San Miguel and the Rio Grande Valley. Four 138 kV circuits supply Laredo and one 69kV circuit runs to Laredo from Corpus Christi. All of the possible upgrade paths have been exhausted except for conversion of the remaining 69kV line to a 138kV line.

Laredo represents over 400MW of load and continues to grow. The Laredo plant—comprised of three units with 30, 35, and 109MW of capacity, respectively—is needed for thermal and voltage transmission support. No new generation is being developed in the area, and the Laredo area is vulnerable to voltage collapse. Were the Laredo units to go offline, existing transmission resources could support approximately 350 MW of load reliably. With Unit 3 offline but the smaller units operating, the Laredo area lines can support approximately 475MW of load reliably. The Laredo area is expected to reach this load level in 2007.

Mr. Bojorquez presented the Board with three alternatives: (1) approve construction of the 150 MW CFE Tie and the San Miguel to Highway 59 345 kV project; (2) maintain RMR Service from Laredo

Units 1, 2 and 3; or (3) remand the matter to ERCOT staff with instructions. Mr. Bojorquez recommended that the Board endorse and support the need for the 150 MW Tie with CFE at Laredo and the San Miguel to Hwy 59 345kV transmission project. In the near term, Mr. Bojorquez noted that ERCOT staff also recommends maintaining Laredo units 1, 2 and 3 as RMR units until transmission additions are completed and in service.

Mr. Karnei asked what public interest reason supported construction of the tie with CFE, and how ERCOT would compensate CFE if power were drawn into the ERCOT Region over the tie. Mr. Bojorquez explained that the CFE tie could enable the Reliability Council to reliably meet needs for the 2007-2010 time period during construction of the 345kV line and will be useful during local maintenance and construction clearances. CFE has approximately 10GW of installed capacity in northern Mexico, but only 6,000MW of demand projected for 2004 in the same area. CFE's transmission system can support the energy transfers contemplated in the 150 MW tie studies. However, ERCOT should not rely on the excess CFE supply in the long term since CFE is developing the transmission resources to export the power to interior Mexico. CFE is interested in an agreement with ERCOT to enable ERCOT to purchase emergency energy and allow CFE to make block load transfers in the Del Rio area. Margaret Pemberton, ERCOT General Counsel, pointed out that no contract has yet been negotiated with CFE. Mr. Jones noted that construction of the CFE tie would not begin until late summer 2004, assuming an acceptable agreement is reached with CFE this spring.

Mr. Manning asked what role the ERCOT Board would play with regard to the CFE tie. Ms. Pemberton noted that Board would be giving its endorsement of the ERCOT staff recommendation to build the tie, which is used by the PUCT to decide on transmission projects and the associated costs. Mr. Manning supported the Board making an endorsement, but not approving any expenditures. Mr. Armentrout agreed. Mr. Jones also clarified that the Reliability Council cannot provide incentives for new generation. Mr. Kahn asked if TAC could develop a PRR that would allow the Reliability Council to create incentives for the development of new generation Resources.

Mr. Veiseh then asked about the process for developing generation alternatives. Mr. Jones explained that anyone can propose a project and follow the process set forth in the Protocols for developing Protocol language in support of a new project. Mr. Payton stated that the Regional Planning Groups are the appropriate venue for suggesting alternative ideas and any PRR that might be required to implement a solution.

Mr. Payton asked Mr. Bojorquez to clarify his statement that the tie is "subject to bids." Mr. Bojorquez explained that AEP is the TDSP for the area and effectively has a "right of first refusal" to build the CFE tie, substation and transmission line at Laredo. AEP is willing to complete the project, but the equipment needed would be acquired through a competitive bidding process. He explained that the costs to build the CFE tie might vary from the estimate. Mr. Payton emphasized the need to negotiate a contractual arrangement with CFE in advance of beginning construction on the CFE tie.

Mr. Veiseh moved to endorse and support the need for the 150MW tie with CFE and the San Miguel to Highway 59 345kV project in accordance with the RMR exit strategy presented for Laredo; Mr. Payton seconded the motion. Parviz Adib stated that the PUCT has already looked at the proposed strategy and, if the Reliability Council concludes that the need for these projects is critical, then the PUCT will set processes in motion to authorize the projects. Mr. Adib asked that the motion address the criticality of the need for the CFE tie and the 345kV project. **Mr. Veiseh amended his motion to state that the two projects identified in the motion should carry a critical designation. Mr. Payton seconded the amended motion. The motion passed by unanimous voice vote with no abstentions.**

Finance & Audit Committee Report

Mr. Baggett, chair of the F&A Committee, reported that the Committee covered several topics in its last meeting. First, the F&A Committee considered a modification to the previously approved 2004 Budget to accommodate the PUCT's approval of a \$0.44/megawatt hour System Administration Fee versus the \$0.46 fee the Reliability Council requested. The PUCT approved fee will result in a nearly \$5,000,000 reduction in the 2004 budgeted revenue. Mr. Baggett stated that the ERCOT staff had considered several budget adjustment options to accommodate the revenue reduction. Among the budget adjustments reviewed, and the options recommended by ERCOT staff, were a reduction in operating expenses and a reduction in capital expenditures. The proposed revised 2004 Budget reduces operating expenses by \$2,970,000 and capital expenditures by \$5,000,000 (capital reductions effectively reducing revenue requirements by \$2,000,000 – 40% revenue funding – 60% will be debt funded).

Mr. Kahn asked how debt load figured in the revised 2004 Budget. Mr. Baggett replied that the Reliability Council's financial policy, which is under review, would indicate a debt/revenue funding ratio was of 80/20 while ERCOT was in "startup mode" and would decrease to 60/40 as the company matured. Although "start up mode" has not been clearly defined, the goal for the revised 2004 Budget is a 60/40 debt to equity ratio, which is consistent with the original 2004 budget approved by the Board in October of 2003. Mr. Baggett noted that the Finance and Audit Committee have considered debt and financing issues at great length. Mr. Kahn then asked why the debt/equity ratio seemed to fluctuate. Maxine Buckles, ERCOT Chief Financial Officer, stated that an approximately \$20 million negative variance in spending in 2003 resulting from ERCOT spending about \$15 million less on capital expenditures and about \$5 million less in operating expenses enabled ERCOT to defer some debt. Mr. Kahn noted that changes to the debt/equity ratio can produce significant changes in fee requirements. Mr. Kahn recommended that the Board articulate a policy regarding the debt/equity ratio to help justify the 2005 fee.

Mr. Karnei stated that the Reliability Council could achieve the necessary reduction of revenue-funded capital investment by delaying or slowing certain projects for 2004. Mr. Baggett stated that the budgeting process would become more precise as the PRRs become more accurate in their estimates of cost savings.

Mr. Espinosa moved to approve the revised 2004 budget; Mr. Veiseh seconded the motion. The motion passed with twelve in favor and one abstention (Ogleman).

Mr. Baggett then discussed the current vehicles used to serve ERCOT debt needs. Recent events have presented opportunities for ERCOT to obtain favorable terms to meet its debt needs. Mr. Baggett presented the following proposed resolution:

WHEREAS, the ERCOT Board of Directors deem it desirable and in the best interest of ERCOT, to renew the \$50,000,000 Revolving Credit Facility with banks for an extended facility (from a 364-day facility to a two-year facility) for liquidity purposes at market terms and rates.

WHEREAS, the ERCOT Board of Directors deem it desirable and in the best interest of ERCOT, to negotiate and enter into a Term Loan Facility with banks for \$50,000,000 with a term of up to 4 years to be repaid in equal annual installments at market terms and rates.

THEREFORE, be it RESOLVED that the ERCOT Board of Directors authorize ERCOT staff to renew the \$50,000,000 Revolving Credit Facility with banks for an extended

facility (from a 364-day facility to a two-year facility) at market terms and rates. Be it FURTHER RESOLVED that the ERCOT Board of Directors authorize ERCOT staff to negotiate and enter into a Term Loan Facility with banks for \$50,000,000 with a term of up to 4 years to be repaid in equal annual installments at market terms and rates.

Because of recent developments allowing an opportunity for ERCOT to seek more favorable debt service terms, and because a vote on the financing proposal did not appear as a vote in the Board packet, **Mr. Karnei moved to waive the notice requirement to allow the Board to consider the resolution; Mr. Espinosa seconded the motion. The motion passed with twelve in favor and one opposed (Payton).**

Both financing items will be brought back to the Board for final consideration at the April 20, 2004 meeting.

Mr. Payton asked if the new Term Loan Facility resulted in an increase in total indebtedness, taking into account repayment of other debt, and whether the term loan was secured or unsecured. Ms. Buckles confirmed that the Term Loan Facility—which would be structured to enable the Reliability Council to draw upon the loan in varying amounts—would initially increase the total indebtedness, which currently stands at \$230 million. She noted that all of the Reliability Council’s debt is unsecured. **Mr. Karnei moved to approve the resolution; Mr. Veiseh seconded the motion. The motion passed with eleven in favor, one opposed (Payton) and one abstention (Ogleman) .**

Mr. Baggett noted that the SAS 70 Audit would be discussed in Executive Session. Mr. Baggett then asked Ms. Buckles to comment on the resolution of short payments resulting from the Mirant bankruptcy. Ms. Buckles explained that the Reliability Council distributed \$7.2 million on March 2, 2004 to Market Participants after reaching an agreed stipulation with Mirant. No other creditors of Mirant objected to the stipulation. She also mentioned that the Reliability Council will soon uplift to QSEs representing Load Serving Entities the short payments resulting from the Enron bankruptcy.

H.R. & Governance Committee Report

Mr. Kahn, Chairman of the H.R. & Governance Committee, reported that the Committee received a copy of the Market Participant Survey. The consultant, Opinion Dynamics, will survey more than 1,300 Market Participants. The results will be available for the May Board Meeting.

Mr. Armentrout reported on strategic planning. The Strategic Planning Subcommittee is developing metrics and framing issues for the Board, with a focus on how to bring the Reliability Council out of “startup mode.”

Mr. Manning adjourned the meeting to Executive Session at 1:45 p.m.

Executive Session

The Board met in Executive Session to discuss various matters.

Adjournment

Vice Chairman Manning adjourned the Meeting at approximately 2:00 p.m. **The next Board meeting will take place on April 20, 2004 at the Hilton Austin Airport Hotel in Austin, Texas.**

Board materials and presentations from the meeting are available on ERCOT’s website at: <http://www.ercot.com/calendar/2004calendar/2004boardmaterials.htm>

Margaret Uhlig Pemberton, Corporate Secretary