



# **Electric Reliability Council of Texas, Inc.**

**Financial Statements  
December 31, 2004 and 2003**

# Electric Reliability Council of Texas, Inc.

## Index

December 31, 2004 and 2003

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**Report of Independent Auditors**

To the Members of the Board of Directors  
of Electric Reliability Council of Texas, Inc.

In our opinion, the accompanying statement of financial position and the related statements of activities and statements of cash flows present fairly, in all material respects, the financial position of the Electric Reliability Council of Texas, Inc. (ERCOT), at December 31, 2004 and 2003, and the results of its activities and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of ERCOT management. Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 3, the financial statements as of and for the year ended December 31, 2003 have been restated.

*PricewaterhouseCoopers LLP*

August 10, 2005

**Electric Reliability Council of Texas, Inc.**  
**Statement of Financial Position**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

	<b>2004</b>	<b>2003</b> <b>as restated,</b> <b>see Note 3</b>
Assets		
Current assets		
Cash and cash equivalents	\$ 33,487	\$ 28,068
Accounts receivable	6,888	3,668
Unbilled revenue	7,254	6,227
Restricted cash	22,399	34,010
Prepaid expenses and other current assets	4,499	3,247
Total current assets	<u>74,527</u>	<u>75,220</u>
Property and equipment, net	156,028	131,274
Systems under development	13,486	35,047
Debt issuance costs	1,516	1,464
Total assets	<u>\$ 245,557</u>	<u>\$ 243,005</u>
Liabilities and Unrestricted Net Assets		
Current liabilities		
Accounts payable and accrued liabilities	20,717	31,687
Market settlement liabilities	33,681	34,805
Security deposits	22,445	34,010
Notes payable, current portion	29,387	13,637
Total current liabilities	<u>106,230</u>	<u>114,139</u>
Notes payable	148,976	136,363
Total liabilities	<u>255,206</u>	<u>250,502</u>
Commitments and contingencies (Notes 7 and 9)		
Unrestricted net (deficit)	(9,649)	(7,497)
Total liabilities and unrestricted net deficit	<u>\$ 245,557</u>	<u>\$ 243,005</u>

The accompanying notes are an integral part of these financial statements.

**Electric Reliability Council of Texas, Inc.**  
**Statement of Activities**  
**Years Ended December 31, 2004 and 2003**

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*(in thousands of dollars)*

	<b>2004</b>	<b>2003</b> <b>as restated,</b> <b>see Note 3</b>
Operating revenues		
Transaction fees	\$ 127,047	\$ 93,991
Membership fees and other	2,615	3,253
Total operating revenues	<u>129,662</u>	<u>97,244</u>
Operating expenses		
Salaries and related benefits	39,976	35,920
Depreciation and amortization	44,937	38,022
Facility and equipment costs	8,109	8,105
Consulting and legal services	16,585	14,453
Administrative and other	8,236	5,440
Hardware and software maintenance and licensing	6,185	5,456
Total operating expenses	<u>124,028</u>	<u>107,396</u>
Income (loss) from operations	5,634	(10,152)
Other income (expense)		
Interest income	347	433
Interest expense	(8,133)	(8,490)
Change in unrestricted net assets (deficit)	(2,152)	(18,209)
Unrestricted net assets (deficit), beginning of year	(7,497)	10,712
Unrestricted net deficit, end of year	<u>\$ (9,649)</u>	<u>\$ (7,497)</u>

The accompanying notes are an integral part of these financial statements.

**Electric Reliability Council of Texas, Inc.**  
**Statement of Cash Flows**  
**Years Ended December 31, 2004 and 2003**

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<i>(in thousands of dollars)</i>	<b>2004</b>	<b>2003 as restated, see Note 3</b>
Cash flows from operating activities		
Change in unrestricted net assets (deficit)	\$ (2,152)	\$ (18,209)
Adjustments to reconcile change in unrestricted net assets (deficit) to net cash provided by operating activities:		
Depreciation and amortization	44,937	38,022
Net losses on disposition of capital assets	1,854	-
Changes in operating assets and liabilities:		
Accounts receivable	(3,220)	131
Unbilled revenue	(1,027)	(3,419)
Prepaid expenses and other current assets	(1,252)	176
Accounts payable and accrued liabilities	(1,010)	(1,164)
Net cash provided by operating activities	<u>38,130</u>	<u>15,537</u>
Cash flows from investing activities		
Capital expenditures for property and equipment and systems under development	<u>(59,713)</u>	<u>(36,049)</u>
Net cash used in investing activities	<u>(59,713)</u>	<u>(36,049)</u>
Cash flows from financing activities		
Proceeds from issuance of short-term notes payable	7,000	6,000
Repayment of notes payable	(13,637)	(6,000)
Proceeds from issuance of long-term notes payable	35,000	-
Payment of capital lease obligation	-	(59)
Payment of debt issuance costs	(283)	(31)
Increase in restricted cash	11,611	35,957
Increase (decrease) in market settlement liabilities	(1,124)	8,803
(Decrease) in security deposits	(11,565)	(35,957)
Net cash provided by (used in) financing activities	<u>27,002</u>	<u>8,713</u>
Net increase (decrease) in cash and cash equivalents	5,419	(11,799)
Cash and cash equivalents, beginning of year	28,068	39,867
Cash and cash equivalents, end of year	<u>\$ 33,487</u>	<u>\$ 28,068</u>
Supplemental information		
Cash paid for interest	\$ 9,250	\$ 9,363
Supplemental disclosure of non-cash investing and financing activities		
Accrued capital expenditures	\$ 8,355	\$ 19,938
Capitalized interest	\$ 1,167	\$ 830

The accompanying notes are an integral part of these financial statements.

# **Electric Reliability Council of Texas, Inc.**

## **Notes to Consolidated Financial Statements**

### **December 31, 2004 and 2003**

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*(in thousands of dollars)*

#### **1. Organization and Operations**

The Electric Reliability Council of Texas, Inc. (ERCOT) is an independent, not-for-profit corporation. ERCOT is one of 10 electric reliability regions in North America operating under the reliability and safety standards set by the North American Electric Reliability Council (NERC). Since July 31, 2001, ERCOT has also functioned as the independent system operator for its reliability region which comprises about 85% of the electrical load in Texas. The ERCOT region has an overall generating capacity of approximately 78,000 Megawatts.

The Public Utility Commission of Texas (PUCT) has primary jurisdictional authority over ERCOT. ERCOT is responsible for ensuring the adequacy and reliability of electricity across the state's main interconnected power grid and for operating and settling the electricity markets it administers. ERCOT's market rules and operations are carried out in accordance with its Protocols filed with the PUCT. The ERCOT region is contained completely within the borders of Texas, and it does not interconnect synchronously across state lines to import or export power with neighboring reliability regions. As a result, ERCOT is not under the jurisdiction of the Federal Energy Regulatory Commission.

ERCOT is governed by a Board of Directors composed of 14 members. One board member is selected from each of the following market participant groups: independent retail electric providers, independent generators, independent power marketers, investor-owned utilities, municipally-owned utilities, and electric cooperatives. The remaining eight seats on the Board are filled by three consumer representatives, three unaffiliated Board members, the Chair of the Public Utility Commission of Texas, and ERCOT's Chief Executive Officer. The unique nature of ERCOT's stakeholder Board is balanced to maintain independence from any particular market segment.

#### **2. Summary of Significant Accounting Policies**

##### **Method of Accounting**

The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

##### **Unrestricted Net Assets (Deficit)**

Unrestricted net assets are those that are not subject to restrictions or stipulations and that may be expendable for any purpose in performing ERCOT's objectives. Accordingly, net assets of ERCOT and changes therein are classified and reported as unrestricted net assets (deficit).

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities of the financial statements and reported amounts of revenues, expenses, and capital expenditures during the reporting period. Actual results could differ from those estimates.

# **Electric Reliability Council of Texas, Inc.**

## **Notes to Consolidated Financial Statements**

### **December 31, 2004 and 2003**

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*(in thousands of dollars)*

#### **Cash and Cash Equivalents**

Cash and cash equivalents consist of deposits in banks, money market investment accounts, overnight deposits in government-backed securities and other highly liquid investments with an original maturity date of 90 days or less. Deposits may exceed the Federal Deposit Insurance Corporation's insured limit of \$100 for each account. ERCOT has not experienced any losses on its deposits of cash and cash equivalents.

#### **Restricted Cash**

Restricted cash represents legally restricted amounts received for security deposits from ERCOT's market participants and funds held pending authorization from the bankruptcy court.

#### **Accounts Receivable and Revenue Recognition**

ERCOT funds its operations primarily through transaction fees collected from electric service providers operating within the Texas grid. Pursuant to the ERCOT protocols, the transaction fees are based on actual volume consumption and are approved by the ERCOT board of directors and the PUCT. This fee was forty-four cents per megawatt hour in 2004 and thirty-three cents per megawatt hour in 2003. Revenue from the transaction fees is recognized in the period that the underlying energy transaction occurs. Amounts not yet billed are accrued and presented as unbilled revenue on the statement of financial position.

ERCOT's other revenue relates to services offered to its participants including non-ERCOT load serving entity fees, connectivity to ERCOT's network, wide-area network usage, and membership dues. Revenue related to these services is recognized either as the services are performed or at the completion of the project, assuming ERCOT has no significant continuing obligation and collectibility is reasonably assured. The Company does not maintain an allowance for doubtful accounts as it does not believe it has a material risk of loss associated with lack of collectivity. Membership dues are recognized over the membership period.

#### **Property and Equipment**

Property and equipment consists primarily of computer equipment and buildings for operations, and are recorded at cost. Depreciation is computed on the straight-line method using the half year convention over the estimated life of the asset. The cost of betterments to, or replacement of, property and equipment is capitalized. When assets are retired or otherwise disposed of, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in the income for the period. The Company recognized a loss included in administrative and other expense on the Statement of Activities during 2004 of \$1,854, representing the net book value of property and equipment that was disposed of or no longer in service. Repairs and maintenance costs are expensed when incurred.



**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

ERCOT's depreciable lives (in years) for assets are:

<b>Asset Category</b>	<b>Depreciable Life</b>
Computer Hardware	3
Software	5
Vehicles	5
Furniture and Equipment	7
Mechanical Components	10
Buildings	30
Leasehold Improvements	Life of the lease

**Systems Under Development**

ERCOT continues to develop the information systems and grid operating systems that are being used in its operations. Costs associated with systems under development are evaluated for capitalization in accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Accordingly, ERCOT capitalized direct costs and related indirect and interest costs incurred to develop or obtain these software systems, most of which are being developed in connection with system development contracts with external firms. Internal costs and contract expenditures not related directly to the development of systems, and related testing activities, are expensed as incurred. Costs on completed projects are transferred to property and equipment when the systems are placed in service.

**Interest Capitalization**

Interest is capitalized in connection with the construction of major software systems and buildings and improvements. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. During 2004 and 2003, capitalized interest costs were \$1,167 and \$830, respectively.

**Market Settlement Liabilities**

Market settlement liabilities represent two types of funds: transmission congestion management funds and Qualified Scheduling Entity (QSE) prepayment of their weekly settlement obligations. QSE settlement amounts are collected and redistributed by ERCOT in the normal course of managing the settlement of ERCOT's markets. Such settlement obligations are generally held for less than fifteen days before distribution to the market in accordance with timetables set forth in ERCOT's Protocols.

ERCOT manages a transmission congestion rights (TCRs) program which includes an annual auction for 60 percent of the calendar year's available TCRs and monthly auctions for the remaining 40 percent of TCRs. ERCOT collects and holds the proceeds from the auctions until the proceeds are distributed to QSEs according to provisions of the TCRs program and ERCOT Protocols.

ERCOT's Financial Policies, adopted by the Board of Directors, include a provision that funds held in conjunction with TCRs' auctions may be used to fund ERCOT working capital and capital expenditure needs, within certain guidelines.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

Market settlement liabilities consist of the following at December 31:

	2004	2003
TCRs auction funds	\$ 22,184	\$ 21,780
QSE prepayments of settlement obligations	11,497	13,025
Total market settlement liabilities:	<u>\$ 33,681</u>	<u>\$ 34,805</u>

**Security Deposits**

Market participants not meeting certain creditworthiness standards included in ERCOT protocols may maintain a cash security deposit with ERCOT in order to mitigate credit risk in lieu of providing alternative means of security such as corporate guaranties, letters of credit, or surety bonds. Cash security deposits are classified as restricted cash.

**Income Taxes**

ERCOT is exempt from Federal income tax under Section 501(c)(6) of the U.S. Internal Revenue Code.

**Fair Value of Financial Instruments**

The carrying values reported on the balance sheet for current assets and liabilities and for the line of credit and term notes approximate their fair value. The fair value of the Company's senior notes payable is \$147,523 and \$172,617 as of December 31, 2004 and 2003. The fair value of the Company's long-term debt is estimated based on net present value calculations and quoted market prices for similar issues.

**Reclassifications**

Certain reclassifications have been made to prior year amounts to conform to current year classifications.

**3. Restatement**

In January 2005 a Williamson County grand jury announced indictments related to criminal activities of five former employees of ERCOT and one contractor doing business with the Company, specifically addressing fraudulent activities during 2003 and 2004. The Company and various law enforcement entities have performed investigations into these matters. In connection with these investigations the Company has reassessed its accounting for expenditures relating to activities involving these employees and related vendors and has determined that \$2,302 was improperly capitalized to Property and equipment in 2003.

In February 2005 the Texas Comptrollers of Public Accounts office commenced an audit of the sales and use taxes paid by the company during 2001 through 2004. As described in Note 9, while the audit is not complete the Company has recorded an estimated liability of \$1,968 related to additional sales and use tax obligations at December 31, 2004, of which \$1,082 should have been

# Electric Reliability Council of Texas, Inc.

## Notes to Consolidated Financial Statements

### December 31, 2004 and 2003

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(in thousands of dollars)

recorded at December 31, 2003. Some of these additional tax amounts relate to activities for which the associated costs are capitalized to property and equipment.

In connection with the preparation of the December 31, 2004 financial statements, the Company determined it should present cash flows related to cash held for market settlement liabilities and security deposits as financing activities, not as operating activities as presented in prior periods. Accordingly, the December 31, 2003 statement of cash flows has been restated.

The following table summarizes the impact of these adjustments on previously issued financial statements:

#### Statement of Financial Position

(in thousands of dollars)

	As previously reported	Adjustment	As restated
Property and equipment, net	\$ 132,594	\$ (1,320)	\$ 131,274
Total assets	244,325	(1,320)	243,005
Accounts payable and accrued liabilities	30,605	1,082	31,687
Total current liabilities	113,057	1,082	114,139
Total liabilities	249,420	1,082	250,502
Unrestricted net (deficit)	(5,095)	(2,402)	(7,497)
Total liabilities and net unrestricted assets	244,325	(1,320)	243,005

#### Statement of Activities

(in thousands of dollars)

	As previously reported	Adjustment	As restated
Depreciation and amortization	\$ 38,091	\$ (69)	\$ 38,022
Facility and equipment costs	8,175	(70)	8,105
Consulting and legal services	12,089	2,364	14,453
Administrative and other	5,436	4	5,440
Hardware and software maintenance and licensing	5,383	73	5,456
Total operating expenses	105,094	2,302	107,396
Income (loss) from operations	(7,850)	(2,302)	(10,152)
Change in unrestricted net assets (deficit)	(15,907)	(2,302)	(18,209)
Unrestricted net assets (deficit), beginning of year	10,812	(100)	10,712
Unrestricted net deficit, end of year	(5,095)	(2,402)	(7,497)

**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

**Statement of Cash Flows**

*(in thousands of dollars)*

	<b>As previously reported</b>	<b>Adjustment</b>	<b>As restated</b>
<b>Cash flows from operating activities</b>			
Change in unrestricted net assets (deficit)	\$ (15,907)	\$ (2,302)	\$ (18,209)
Adjustments to reconcile change in unrestricted net assets (deficit) to net cash provided by operating activities:			
Depreciation and amortization	38,091	(69)	38,022
Changes in operating assets and liabilities:			
Restricted cash	35,957	(35,957)	-
Market settlement liabilities	8,803	(8,803)	-
Accounts payable and accrued liabilities	(1,233)	69	(1,164)
Security deposits	(35,957)	35,957	-
Net cash provided by operating activities	26,642	(11,105)	15,537
<b>Cash flows from investing activities</b>			
Capital expenditures for property and equipment and systems under development:	(38,351)	2,302	(36,049)
Net cash used in investing activities	(38,351)	2,302	(36,049)
<b>Cash flows from financing activities</b>			
Increase in restricted cash	-	35,957	35,957
Increase in market settlement liabilities	-	8,803	8,803
(Decrease) in security deposits	-	(35,957)	(35,957)
Net cash provided by (used in) financing activities	(90)	8,803	8,713

**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

**4. Property and Equipment**

Property and equipment consists of the following at December 31:

	<b>2004</b>	<b>2003</b> <b>as restated,</b> <b>see Note 3</b>
Computer equipment and software	\$ 196,015	\$ 157,222
Buildings and leasehold improvements	49,792	48,890
Furniture and fixtures	6,190	5,914
Land and improvements	246	246
Vehicles	129	129
	<u>252,372</u>	<u>212,401</u>
Accumulated depreciation	<u>(109,730)</u>	<u>(81,127)</u>
	142,642	131,274
Construction in progress	13,386	-
Total property and equipment, net:	<u>\$ 156,028</u>	<u>\$ 131,274</u>

**5. Notes Payable**

ERCOT's notes payable consist of the following:

	<b>2004</b>	<b>2003</b>
Revolving line of credit	\$ 7,000	\$ -
Term loan	35,000	-
Senior notes	136,363	150,000
	<u>\$ 178,363</u>	<u>\$ 150,000</u>

ERCOT has two financing facilities with JPMorgan Chase Bank, as Agent for a group of Lenders, a revolving line of credit and a term loan. The revolving line of credit has a maximum amount of available credit of \$50,000 and expires on May 6, 2006. The term loan has a maximum amount of available credit of \$50,000 and expires in November 2008 with principle payments due ratably through November 2008. The interest rates on these facilities are based on the type of advance being made and can be set based on prime rate, a LIBOR based rate, or other rate as described in the debt agreements. The effective rates of interest on borrowed funds at December 31, 2004 were 2.815% for the revolving line of credit and 2.505% for the term loan. The credit agreements have several covenants, the most restrictive of which limit borrowings and investments, and requires a certain minimum interest coverage to be maintained. At December 31, 2004, ERCOT was in compliance with its covenants. In April 2005, these debt agreements were refinanced which

**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

resulted in extended final maturity on the revolving line of credit and reduced interest rates on both facilities.

ERCOT's senior notes bear interest at 6.17% and are due in term payments through May, 2014. ERCOT may prepay the notes subject to make-whole provisions established in the offering. The debt agreements have several covenants, the most restrictive of which limits ERCOT's indebtedness and requires the maintenance of an interest reserve equal to the amount of the next installment of interest. The reserve is satisfied by the revolving line of credit. At December 31, 2004, ERCOT was in compliance with its covenants for the senior notes.

Future maturities of the notes are as follows:

<b>Year Ending December 31</b>	<b>Senior Notes</b>	<b>Term Loan</b>	<b>Line of Credit</b>	<b>Total</b>
2005	\$ 13,637	\$ 8,750	\$ 7,000	\$ 29,387
2006	13,637	8,750		22,387
2007	13,637	8,750		22,387
2008	13,637	8,750		22,387
2009	13,637			13,637
Thereafter through 2014	68,178			68,178
	<u>\$ 136,363</u>	<u>\$ 35,000</u>	<u>\$ 7,000</u>	<u>\$ 178,363</u>

At December 31, 2004, ERCOT had net capitalized issuance costs related to the notes of \$1,516, classified in non-current assets, and amortized over the life of the notes.

## **6. Employee Benefit Plans**

ERCOT sponsors two defined contribution retirement plans: the ERCOT Defined Contribution 401(k) Plan (the "401(k) Plan") and the ERCOT Money Purchase Plan (the "MP Plan"), which are subject to the provisions of the Employee Retirement Income Security Act of 1974. The 401(k) Plan and the MP Plan utilize a third-party administrator to assist in the administration. Employees participating in the 401(k) Plan are fully vested after five years and employees in the MP Plan are fully vested after 3 years. Employees must be 21 years of age to be eligible to participate in either plan.

For the 401(k) Plan, ERCOT matches 75% of the employee's contribution up to 6% of compensation as defined in the 401(k) Plan document. Employer contributions to the 401(k) Plan were \$1,179 and \$1,054 for the years ending December 31, 2004 and 2003, respectively.

For the MP Plan, ERCOT contributes 10% of a participant's annual salary as defined in the MP Plan document. Employer contributions to the MP Plan were \$2,926 and \$2,705 for the years ended December 31, 2004 and 2003, respectively.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

**7. Lease and Contract Commitments**

The Company has noncancellable operating leases and service contracts providing telecommunication services, system infrastructure and office facilities. Most notably, ERCOT leases approximately 45,000 square feet of office space in Austin, Texas under a 120 month lease. The facility lease began in the second quarter of 2001 and includes provisions for two 60 month renewals upon completion of the initial lease term. Minimum payments due under these commitments are:

2005	\$	714
2006		661
2007		661
2008		661
2009		661
Thereafter		928
Total minimum lease payments:	\$	<u>4,286</u>

**8. Concentrations**

ERCOT provides reliability services to QSE's. ERCOT settles the costs of these services by passing through the costs of such services from the providers to the users of such services. In the event that a QSE is unable to make payment on its market obligations, ERCOT's Protocols stipulate that the amount of the default is to be allocated proportionately to the remaining QSE's. In order to limit the risks associated with such occurrences, ERCOT requires a cash security deposit, letter of credit, corporate guaranty, or surety bond from the QSEs if they do not meet a certain credit standards. Credit risk related to trade receivables associated with ERCOT's system administration fee is substantially mitigated by the fact that, by Protocol, ERCOT's administrative fee is paid from market receipts as a first priority before any market obligations are paid.

ERCOT's system administration fee revenue is driven by the demand for electricity rather than the number of QSEs. In the event that any QSE ceased to operate, another QSE would assume the role in response to the demand for electricity. As such, ERCOT believes its exposure to a material reduction in revenues associated with the loss of any QSE is limited.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Consolidated Financial Statements**  
**December 31, 2004 and 2003**

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*(in thousands of dollars)*

**9. Contingencies**

**Sales and Use Tax Audit**

In March 2005 the Texas Comptroller of Public Accounts' office (Comptroller) initiated an audit of ERCOT's sales and use tax payments and obligations for the four-year period covering 2001 through 2004. While the audit is not complete, the Company has received preliminary feedback from the Comptroller and has reassessed substantially all of its transactions potentially subject to sales and use tax over the audit period. Based on this reassessment, the Company estimates its additional sales and use tax liability in connection with this audit to be \$1,968 inclusive of estimated interest and penalties. The actual amount of additional tax liability will not be finalized until the Comptroller provides its formal assessment and the Company either accepts or contests the findings, a process that is not expected to be completed for several months. Since no agreement has been reached to date with the Comptroller and since there are several issues that are being addressed in the audit, the actual liability will almost certainly differ from the Company's current estimate. However, management believes that the ultimate liability will not be materially different from their estimate of \$1,968, which is included in accounts payable and accrued liabilities in the 2004 statement of financial position.

As described in Note 3, the Company's 2003 financial statements have been restated. The Company's estimated sales and use tax liability at December 31, 2003 relating to transactions occurring through that date is \$1,082 which is included in accrued liabilities in the restated 2003 statement of financial position.

**General Contingencies**

The Company is party to regulatory and legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject. Such proceedings are not anticipated to have a material impact on ERCOT's financial condition, results of operations or cash flow.