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Date: February 14, 2006
To: Board of Directors
From: Clifton Karnei, Finance and Audit Committee Chair
Subject: Amendments to Finance and Audit Committee Charter

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: February 21, 2006

Agenda Item No.: 10a

Issue:

The composition of the Finance and Audit (F&A) Committee membership, as set forth in the Committee Charter.

The F&A Committee considered this issue at its January meeting, and approved a formal recommendation for the Board to approve an amendment to the Committee Charter clarifying that the F&A Committee must include at least three (3) Segment members and one (1) or more Independent Board members, as described in Attachment A.

Background/History:

Last year due to the unworkable requirement that all Segments be represented on the F&A Committee ERCOT amended the Charter. The amendment provided that, since each Segment had only one representative on the Board, the F&A Committee would be comprised of at least five (5) board members, with one or more being an Independent Board member. The current revision requested merely clarifies that at least three (3) Segments must be represented on the F&A Committee as well as at least one (1) Independent Board member.

Key Factors Influencing Issue:

Confirm that the F&A Committee membership will remain a combination of Segment and Independent Board Members.

Alternatives:

(1) Approve proposed F&A Committee Charter amendment as recommended by the Committee; (2) reject the Committee’s recommendation; or (3) remand this issue to the Committee with instructions.

Conclusion/Recommendation:

The Chair requests the Committee recommend amendment of the F&A Charter to require that the five (5) member F&A Committee be comprised of at least three (3) Segment Board



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Members and one (1) or more Independent Board Members.



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ATTACHMENT A THE ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC. FINANCE & AUDIT COMMITTEE CHARTER

Purpose

The Finance and Audit committee of the Board of Directors of ERCOT shall:

1. oversee the Company's budget process and adherence to budget, and providing recommendations to the Board of Directors for establishing levels of financing and in setting the Company's fees, including its administrative fee;
2. review the Company's credit policies and make recommendations to the Board of Directors re same;
3. ensure that the Company's financial statements are properly and effectively audited by qualified accountants who are independent;
4. assist the Board of Directors in fulfilling its oversight responsibility with respect to the Company's maintenance of an effective internal audit function;
5. perform such other duties and responsibilities enumerated in and consistent with this Charter.

The Committee's function is one of oversight, recognizing that the Company's management is responsible for preparing the Company's financial statements, and the independent auditor is responsible for auditing those statements. In adopting this Charter, the Board of Directors acknowledges that the Committee members are not employees of the Company and are not providing any expert or special assurance as to the Company's financial statements or any professional certification as to the external auditor's work or auditing standards. Each member of the Committee shall be entitled to rely on the integrity of staff and external auditors to provide accurate, complete financial and other information to the Committee, absent actual knowledge to the contrary.

While the Committee has the responsibilities, duties and powers set forth in this Charter, it shall be the responsibility and duty of the Company's management and independent auditor, and not the responsibility or duty of the Committee, to plan or conduct audits or to make any determination that the Company's financial statements are complete and accurate and in accordance with generally accepted accounting principles, and it shall not be the responsibility or duty of the Committee to conduct investigations, resolve disagreements, if any, between management and the independent auditor or to assure compliance with laws and regulations or the Company's ethics policies.



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The Committee shall provide assistance to the Board in fulfilling its oversight responsibility relating to the Company's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the annual independent audit of the Company's financial statements and the legal compliance and ethics programs as established by management and the Board. In so doing, it is the responsibility of the Committee to maintain free and open communication between the Committee and the Company's independent auditors, internal accounting personnel and management.

Membership

The Finance and Audit Committee of the Board of Directors of ERCOT (the “Committee”) shall be comprised of at least five Board members, **at least three of which are from market Segments and** one or more of which must be an Independent Board members of ERCOT (the “Company”). Each Member must be able to read and understand fundamental financial statements, including the balance sheet, income statement and cash flow statement. At least one Member must have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background which ensures the individual’s financial sophistication, including a past or current position as a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

The board members shall decide from among themselves who shall participate in the Committee. The term shall be for one year.

The Chair of the Committee shall be selected through a majority vote of the Committee members. The Committee Chair shall not be the Chief Executive Officer of the Company and shall have accounting or related financial management expertise.

The Committee may request that any officers or employees of ERCOT, or any other person, whose advice and counsel are sought by the Committee, attend any meeting of the Committee to provide such pertinent information as the Committee requests.

Board members (other than Committee members) may attend and participate in Committee meetings but may not participate in Committee voting.

Non-Committee members may attend Committee meetings at the discretion of the Committee. The Committee may exclude any persons who are not Directors, the Segment Alternate or the Director’s Designated Representative from any meeting or portion of any Committee meeting that the Committee determines, in its discretion, needs to be held in closed session to discuss



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personnel issues, confidential legal matters, negotiations or other business of the Committee involving confidential information.

Qualifications

Each member of the Committee shall also meet any experience requirements as may be established from time to time by the Board of Directors. The Board of Directors shall endeavor to appoint at least one member to the committee who is a financial expert as such term may be defined from time to time by the Board of Directors, the accounting industry or other regulatory authorities.

Authority

In discharging its oversight role, the Committee is empowered to investigate any matter brought to its attention with full access to all books, records, facilities and personnel of the Company and the power to retain outside counsel or other experts for this purpose. All employees are directed to cooperate as requested by the Committee or any of its Members for Committee purposes. The Committee may request any officer or employee of the Company, the Company's outside counsel or the Company's independent auditor to attend a meeting of the Committee or to meet with any Member or any consultants to the Committee.

The Company's senior internal auditor shall report directly to the Committee. For administrative purposes, the senior internal auditor shall report to the CEO. The Committee shall approve an Annual Audit Plan prepared by the senior internal auditor. The senior internal auditor shall (1) manage the execution of the Annual Audit Plan, (2) conduct investigations at the direction of the Chair and the Committee, and (3) make periodic reports to the Committee at regularly scheduled Committee meetings and as otherwise directed by the Chair and the Committee.

The Committee may appoint workgroups or task forces to investigate issues defined by the Committee. Members of such workgroups or task forces need not be Directors. Such workgroups or task forces shall have no authority to bind the Committee or the Company.

Structure

Three members of the Committee shall constitute a quorum. At any meeting at which a quorum exists, the act of a majority of the members present at a meeting shall be the act of the Committee.



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The Chair, in consultation with the Chief Financial Officer, shall develop the agenda, the frequency, and length of meetings and shall have unlimited access to management and information for purposes of carrying out functions of the Committee. The Chair shall establish such other rules, as may from time to time be necessary and proper for the conduct of the Committee.

Duties and Responsibilities

The following shall be the prominent recurring duties and responsibilities of the Committee in carrying out its oversight functions. The duties and responsibilities are set forth below as a guide to the Committee with the understanding that the Committee may alter or supplement them as appropriate under the circumstances to the extent permitted by applicable law, and by the Company's Articles of Incorporation and Bylaws:

With respect to budget oversight and financing:

1. Annually, on a schedule to be established by the Board of Directors, the Committee shall review staff's proposed budget for the following year, including proposed staffing levels, proposed capital expenditures, and other proposed expenditures.
2. The Committee shall review the staff's estimate of revenues to support all proposed expenditures, including staff's recommendations for fee levels for the following year.
3. The Committee shall review the staff's recommendation of the amount and type of financing that may be needed to support the proposed budget, including the staff's proposed financial performance measures (e.g. ratios).
4. Following the Committee's review of the above items, the Committee shall recommend to the Board of Directors a staffing level, a proposed budget, proposed fees, and proposed financial performance measures for the following year.

With respect to the Company's credit policy:

1. The Committee shall review staff's recommendations concerning changes to the credit policy established to ensure creditworthiness of market participants.
2. Following the Committee's review of staff's recommendations, the Committee shall recommend to the Board of Directors any proposed changes to the previously approved credit policy.

With respect to the independent auditors:

1. Annually, the Committee shall recommend to the Board of Directors the selection and employment of the Company's independent auditor. The Committee shall fulfill the oversight responsibility of the Board of Directors with respect to the independent



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- auditors' audit of the books and accounts of the Company and for the fiscal year for which it is appointed.
2. The Committee shall approve the provision of all auditing and non-audit services by the independent auditor to the Company in advance of the provision of those services and shall also approve the fees for all non-audit services provided by the independent auditor.
 3. In connection with the Committee's approval of non-audit services, the Committee shall consider whether the independent auditor's performance of any non-audit services is compatible with the external auditor's independence.
 4. At least annually, the Committee shall obtain and review a report by the independent auditor describing:
 - a. the independent auditor's internal quality control procedures;
 - b. all relationships between the independent auditor and the Company, in order to assess the auditor's independence
 5. The Committee shall also review any report by the independent auditor describing:
 - a. significant accounting policies and practices used by the Company;
 - b. alternative treatments of financial information as required to be discussed by the independent auditors with the Committee; and
 - c. any other material written communication between the independent auditors firm and the Company's management.
 6. Establish the Company's hiring policies for employees who are former employees of the Company's independent auditors

With respect to the Company's financial statements:

1. The Committee shall discuss the annual audited financial statements with management and the independent auditor, including the Company's disclosures.
2. The Committee shall review disclosures made to the Committee by the Company's CEO and CFO about any significant deficiencies in the design or operation of the internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.
3. In connection with its review of the Company's financial statements, the Committee shall review and discuss with the independent auditor the matters relating to the conduct of the audit as they may be modified or supplemented, including, but not limited to, significant judgments, significant estimates, critical accounting policies, and unadjusted differences.
4. Review major changes to the Company's auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.
5. Review with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or published reports that raise material issues regarding the Company's financial statements or accounting policies.



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6. Review with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.
7. Review any and all press stories that relate to the Company's accounting and disclosure, require that management or the auditor explain any negative comments and determine whether these comments necessitate a change in the accounting structure of the Company.
8. Based on its review and discussions with management, the internal auditors and the independent auditor, the Committee shall provide a recommendation to the Board of Directors whether the Company's financial statements should be accepted.

With respect to periodic reviews and reports:

1. Periodically, the committee shall meet separately with senior management, internal auditors and the independent auditors.
2. The Committee shall review with the independent auditor any audit problems or difficulties and management's response to them.
3. The Committee shall review the Company's policies with respect to risk assessment and risk management.
4. The Committee shall communicate to the Board of Directors the matters discussed at each meeting of the Committee, including any issues with respect to the quality or integrity of the Company's financial statements, the performance and independence of the Company's independent auditors or the performance of the internal audit function.
5. The Committee shall discuss with the Board of Directors the matters discussed at each meeting of the Committee.
6. The Committee shall review and assess the adequacy of this Charter annually and recommend any proposed changes to the Board of Directors.

With respect to the other matters:

1. The Committee shall inquire of management and the independent auditors about significant risks or exposures to the Company and the ERCOT market and assess the steps management has taken to minimize such risks.
2. The Committee shall establish procedures for:
 - a. The receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and
 - b. The confidential, anonymous submission by the Company's employees of concerns regarding accounting or auditing matters.
3. The Committee shall review, based on the recommendations of the independent auditors and the CFO, the scope and plan of the work to be done by the Company's internal auditor, and the results of such work.



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4. The Committee shall establish the Company's hiring policies for employees who are former employees of the Company's independent auditor's review the appointment and replacement of the senior internal auditing executive, the scope of the internal audit plan and the significant reports to management prepared by the internal auditing department and management's responses.
5. Meet at least biannually with the independent auditor, the chief financial officer and the senior internal auditing executive in separate executive sessions.

Meetings

The Committee shall meet at least once during each fiscal quarter, and as many additional times as the Committee shall deem necessary or appropriate.

Minutes

The Committee shall designate a secretary, who shall prepare or cause to be prepared the minutes of each meeting and file such minutes with the corporate records of the Company. The secretary shall send, or cause to be sent, copies of such minutes to each of the Members.

Evaluation

The Committee shall undertake an annual evaluation assessing its performance and, in light of this, consider changes in its membership, charter or procedures. The Committee shall report to the Board the results of its evaluation, including recommended charter, membership and other changes, if any.



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Attachment B

RESOLUTION OF THE BOARD OF DIRECTORS OF ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.

February 21, 2006

WHEREAS, the Board of Directors (the “Board”) of the Electric Reliability Council of Texas, Inc. (the “Company” or “ERCOT”) deems it desirable and in the best interest of the Company to amend the Finance and Audit Committee Charter to specifically provide that the membership of the Committee will be comprised of at least three (3) Segment members and at least one (1) Independent Board member;

BE IT RESOLVED that the Board hereby amends the first sentence of the Membership section of the Finance and Audit Committee Charter to read, “The Finance and Audit Committee of the Board of Directors of ERCOT (the “Committee”) shall be comprised of at least five Board members, at least three of which are from market Segments and one or more of which must be an Independent Board members of ERCOT (the “Company”).