



## ERCOT Finance & Audit Committee Meeting

**ERCOT**

**7620 Metro Center Drive, Austin, Texas**

**March 21; 8:00 to 10:00 a.m.\*\***

**Toll Free Dial In Number 866.793.9858**

**Participant Passcode 8832290**

Agenda Item #	Description/Purpose/Action Required	Presenter	Time
	<b>Call to Order</b>	<b>C Karnei</b>	<b>8:00 a.m.</b>
<b>1.</b>	<b>Approval of Minutes* (Vote)</b>	<b>C Karnei</b>	<b>8:00 a.m.</b>
<b>2.</b>	<b>Review Nodal Financing Scenarios (Vote)</b>	<b>C Yager</b>	<b>8:05 a.m.</b>
<b>3.</b>	<b>Review Corporate Policy Framework</b>	<b>C Moseley</b>	<b>8:25 a.m.</b>
<b>4.</b>	<b>Large Projects</b>	<b>R Connell</b>	<b>8:35 a.m.</b>
<b>5.</b>	<b>Review Committee Evaluation/Self Assessment results</b>	<b>S Byone</b>	<b>8:40 a.m.</b>
<b>6.</b>	<b>Credit Workgroup Administration</b> <ul style="list-style-type: none"> <li>• <b>Review and ratify charter (Vote)</b></li> <li>• <b>Confirm CWG chairman (Vote)</b></li> </ul>	<b>C Yager</b>	<b>8:40 a.m.</b>
<b>7.</b>	<b>Managing Credit Risk – Next Steps</b>	<b>M Davies</b>	<b>8:55 a.m.</b>
<b>8.</b>	<b>Review guidelines for engagement of external auditors for Other Services</b>	<b>M Petterson</b>	<b>9:10 a.m.</b>
<b>9.</b>	<b>Committee Briefs – Q&amp;A</b>	<b>All</b>	<b>9:15 a.m.</b>
<b>10.</b>	<b>Future Agenda Items</b>	<b>S Byone</b>	<b>9:20 a.m.</b>
	<b>Adjourn to Executive Session</b> <ul style="list-style-type: none"> <li>▪ <b>TBD</b></li> </ul>	<b>C Vance</b>	<b>9:30 a.m.</b>
	<b>Adjourn</b>		<b>10:00 a.m.</b>

*\*\* Background material enclosed or will be distributed prior to meeting. All times shown in the Agenda are approximate  
The next FA Committee Meeting will be held March 21, at ERCOT, 7620 Metro Center Drive, Austin, Texas.*

**Draft MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING**

Austin Met Center

7:30 A.M.

**February 21, 2006**

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 7:30 a.m. and immediately retired for a closed executive session regarding personnel matters, until approximately 8:10 a.m. The Committee reconvened at approximately 8:15 for the open public session. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

**Meeting Attendance****Committee members:**

Clifton Karnei, <i>Chair</i>	Brazos Electric Cooperative	Cooperative	Present
Darrell Hayslip, <i>Vice Chair</i>	Calpine Corporation	Ind. Generator	Not Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
Miguel Espinosa	Independent Board Member	Independent Board Member	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present

**ERCOT staff and guests present:**

Barry, Sean	PricewaterhouseCoopers
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Connell, Robert	ERCOT
Doolin, Estrellita	ERCOT
Ettorre, Ed	ERCOT
MEEK, Don	ERCOT
Moseley, Cheryl	ERCOT
Mueller, Geoff	ERCOT
Petterson, Mike	ERCOT
Schwerdtfeger, Kathie	Deloitte & Touche
Sundhararajan, Srin	ERCOT
Troxell, David	ERCOT
Uffelman, Bernie	Deloitte & Touche
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
West, James	PricewaterhouseCoopers
Yager, Cheryl	ERCOT

### **Approval of Previous Minutes**

**Bob Manning moved to approve the Minutes for the previous regular meeting held January 17, 2006; Tom Standish seconded the motion. The motion passed.**

### **Finance & Audit Committee Charter**

**Bob Manning moved to approve the recommended changes to the Committee Charter that had been discussed at the previous Committee meeting. Tom Standish seconded the motion. The motion passed.**

### **Audit Planning**

#### **1. 2005 PwC Financial Audit**

Sean Barry and James West of PriceWaterhouseCoopers (PwC) reviewed the PwC audit plan, including a summary of the mutual understanding and expectations between management and PwC, an analysis of key risks, the PwC audit approach, reporting/ audit timetable and other matters. Mr. West discussed five key risk areas: (1) reserves and accruals, specifically including sales and use tax liabilities; (2) accounting for contracts with third-party vendors that provide services and software development activities; (3) management and accounting for fixed assets including physical identification and costs capitalized as fixed assets, (4) detection of fraudulent activity; and (5) evaluation and assessment of intangibles, including software amortization lives and usefulness of capitalized software costs.

#### **1. Benefits Plan Follow-up**

Steve Byone provided a brief update on Nancy McIntire's behalf and noted that ERCOT was doing everything possible to resolve issues identified prior to 2006 and that management could not say with certainty that there would be no issues identified in 2006. He noted that corrections of prior years was still in progress and since these were effected in 2005 and 2006 the results for 2005 and 2006 would be impacted. Mr. Byone informed the committee that more information would be shared during the Board retreat and at Committee meetings over the course of 2006 as any additional issues were identified.

#### **2. SAS 70**

Steve Byone and Jim Brenton updated the Committee on specific actions management had taken and was in the process of taking to prepare for the 2006 SAS 70 audit including (1) assembly of SAS 70 Readiness Team, (2) user provisioning for cyber and physical security, (3) hardening standards for cyber security, and (4) closed circuit television in digital format for physical security. Mr. Brenton explained that, until ERCOT was able to have an automated logical security system in place, security would do an annual 100% manual recertification of logical access.

#### **3. Internal Controls Assessment**

Steve Byone informed the Committee that management and the PUC staff were working together to develop plans to conduct a third party follow-up review of progress on internal controls. The review will be performed during the summer and findings would be available by late August 2006. Mr. Byone informed the committee that due to a combination of an increased scope in work and a need to make the review findings publicly available there would be an increase in cost relative to the estimate previously provided and included in the budget.

#### **4. Sales Tax Audit**

Mike Petterson reported to the Committee the results of the sales and use tax audit conducted by the Comptroller of Public Accounts beginning in April 2005, for the period 2001 – 2004 and described management's plan to challenge the proposed \$2.6 million liability, which was \$600,000 more than ERCOT accrued as of December 2004. Mr. Petterson explained that the discrepancy between the proposed liability and the amount accrued by ERCOT was due to the Comptroller's reliance on a recent, unpublished interpretation which generally expands the type of third-party software consulting services that are subject to Texas sales and use tax. He also informed the Committee that ERCOT may pay the proposed sales tax liability to stop additional interest and penalties from accruing during the hearing and appeal process.

#### **Large Projects Briefing**

Mr. Connell noted that three projects were completed in January and that 4 large projects, 2 of which would be presented to the Board in Executive Session for approval, later in the day.

#### **Finance Update**

##### **1. Early Debt Retirement**

Cheryl Yager informed the Committee that because the TCR revenues were higher than expected and ERCOT can borrow against TCR revenues at a lower rate, management intended to prepay the November 1, 2006 Term Loan payment. Ms. Yager explained that she expected that this payment would be made at the end of February and that the cost savings obtained were expected to total between \$16,000 and \$33,000.

##### **2. Nodal Financing Discussion**

Cheryl Yager reminded the Committee that the working estimate of Nodal Market Redesign cost was approximately \$125 Million, and that, at the Committee's request, management had discussed methods to fund the Nodal Market Redesign efforts. Ms. Yager informed the Committee that management proposed collecting revenues early and funding with a blend of revenue and debt. Ms. Yager proposed that ERCOT would request a separate fee for the \$125 Million, spread over 7 years (the construction period plus the useful life of the hardware and software), and that she estimated the revenue requirement would be between 6 and 6.5 cents per MWH, given those assumptions. Clifton Karnei mentioned that the Committee wanted to review some ideas for funding, so they could consider whether to "front load" the funding to cover developmental costs as they are incurred or "back load" the funding to match funding with the anticipated benefits from Nodal. Mr. Byone informed the Committee that based upon the November letter to the PUC, ERCOT had begun spending on Nodal, and he anticipated that a filing would need to be made to bring the funding matter before the Commission prior to the next committee meeting.

Tom Standish asked Ms. Yager what the useful life of the items purchased for \$125 Million would be, and she responded that the hardware and software would have a life of 3 to 5 years. Mr. Standish suggested that the Committee should consider accruing money for long-term depreciation and upgrades. Mr. Standish asked that the cost over the long-term be looked at, to ensure that all people benefiting would pay their fair share. Mr. Karnei reminded the Committee that, regardless of the initial method of funding, there would need to be period review of the cost allocation and payment. Ms. Yager noted that ERCOT needed to consider overall debt as well as the timing of payments for the Nodal effort. Mr. Standish indicated that users down the road could pay for the benefits of Nodal, and the debt level could still be reasonable, but Mr. Byone mentioned that, because ERCOT doesn't have any tax incentive to carry debt, the high cost of

carrying debt must be considered. Mr. Byone suggested that by requesting PUC action regarding needed funding an official process to obtain input from the market could be started.

Scott Gahn asked if the Committee needed to approve the filing for the Nodal funding, and Mr. Karnei responded that it was still being researched, but that, in any case, for governance purposes, the Committee would like to see the options for funding that would be filed, so that the members could give comments before the filing was made. The Committee discussed whether one funding recommendation or various methods of possible funding should be filed. Mr. Mann recommended that ERCOT present options for funding, with the implications of each method listed. Mr. Byone informed the Committee that ERCOT could recommend methods of financing, but would not recommend who would pay or how the fee should be assessed among market participants.

### **Credit Statistics**

Ms. Yager informed the Committee that PRR 638, which has a positive credit impact, because it shortens the invoice payment cycle from 16 days to 5 business days, would be before the Board for a vote, later in the day.

### **F&A Committee Self Assessment**

Mr. Karnei noted that the F&A Committee self assessment document presented by Mr. Byone was the first written assessment that they had received. Mr. Karnei told the Committee that if any member had any additional questions that he wanted to add, he should send the question to Mr. Byone, who would add the questions and send out the final self assessment document. Mr. Karnei asked each member to complete the self assessment and told them that Mr. Byone would tabulate the results for review at the next meeting.

### **Future Finance & Audit Committee Meeting Agenda Items**

Mr. Byone reviewed the list of potential future Committee agenda items with the Committee. Mr. Karnei noted that he would not be available to be at the March 21<sup>st</sup> meeting in person, so he asked if Bob or Mike could chair if Darrell was not available.

### **Adjournment**

The meeting was adjourned at approximately 9:29 a.m., and the Committee went into Executive Session. The next meeting will be held on the morning of Marcy 21, 2006.

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Susan Vincent, Secretary

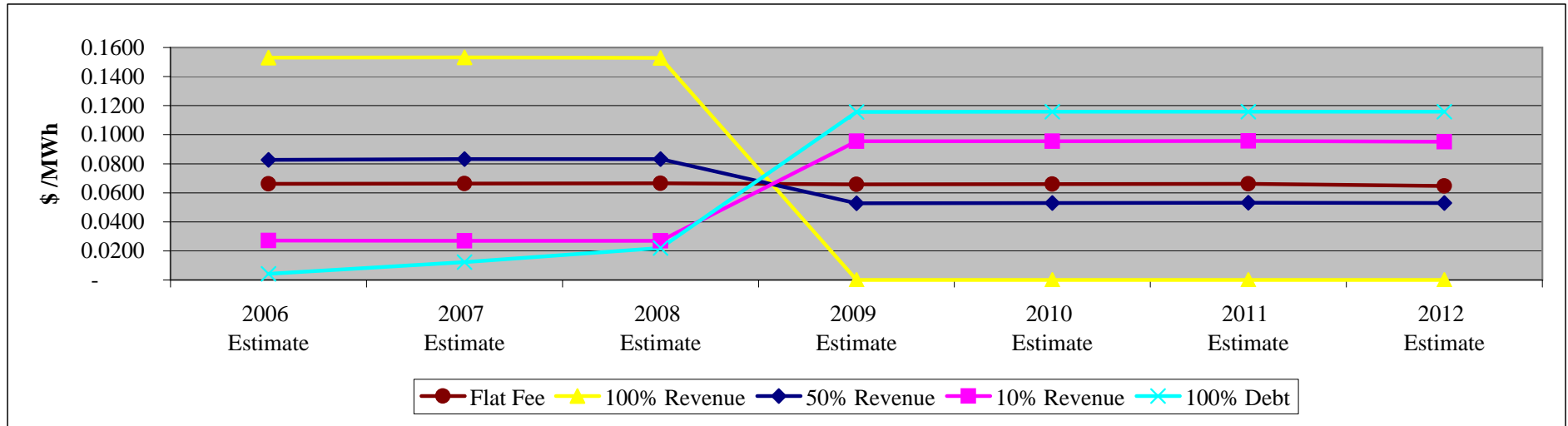
## ERCOT Nodal Funding Summary Comparison

Line	Option / Scenario	Description	Average Fee		Nodal Debt Impact		Various Impacts			
			2006 to 2008	2009 to 2012	Est Max Debt O/S for Nodal	Est Total Interest Cost	Lowest Total Cost	Level Fee Profile	Match Recovery to Asset Life	Financial Impact on ERCOT, Inc.
1	Flat Fee (38% Revenue / 62% Debt)	Use borrowed funds and new fees to produce a relatively flat fee over the period 2006-2012. Approximately 38 percent of wholesale market redesign funded on pay-as-you-go basis over the development period (2006-2008).	0.0663	0.0657	77.4	16.6	No	Yes	Yes	Strengthen (-)
2	100% Revenue	Establish current new fees to fund 100 percent of wholesale market redesign on a pay-as-you-go basis over the development period (2006-2008) .	0.1530	0.0000	12.7	0.7	Yes	No	No	Strengthen (+)
3	50% Revenue	Establish new fees to fund 50 percent of wholesale market redesign on a pay-as-you-go basis over the development period (2006-2008). The remaining project cost is debt funded and repaid with interest over the period 2009-2012.	0.0831	0.0530	62.4	13.6	No	No	Yes	Strengthen (-)
4	10% Revenue	Establish new fees to fund 10 percent of wholesale market redesign on a pay-as-you-go basis over the development period (2006-2008). The remaining project cost is debt funded and repaid with interest over the period 2009-2012.	0.0270	0.0955	112.5	23.8	No	No	Yes	Weaken
5	100% Debt	Debt fund 100 percent of the costs of wholesale market redesign and repay with interest over the period 2006-2012. Estimated maximum debt includes interest paid on borrowings during the development period.	0.0128	0.1158	136.5	28.8	No	No	Yes	Weaken

### Key Assumptions

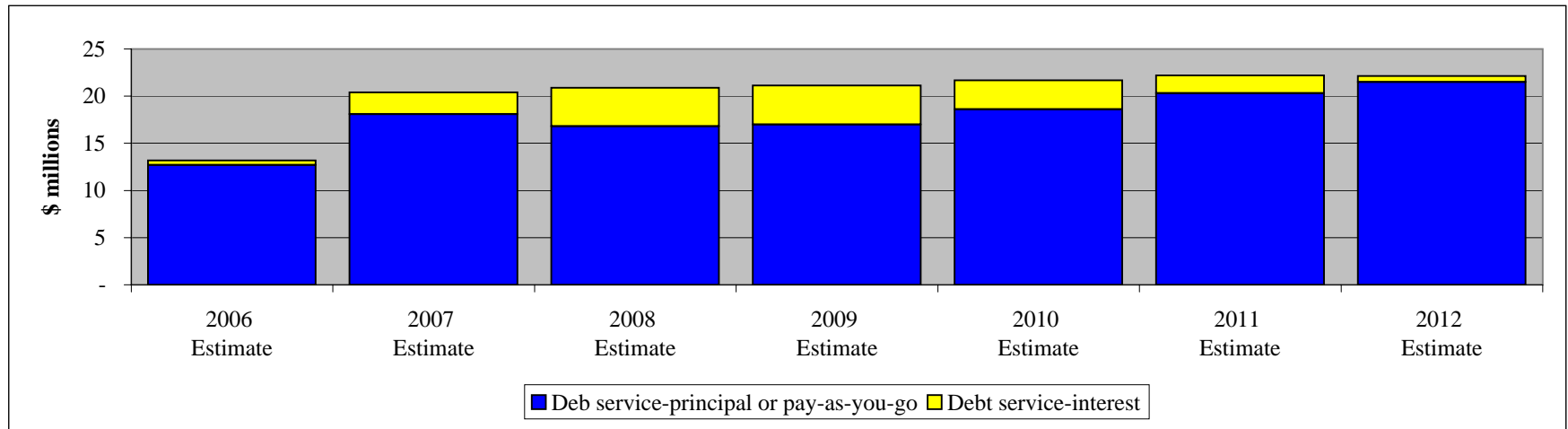
- \$125 million total cost of wholesale market redesign allocated \$30 million, \$60 million, and \$35 million over 2006, 2007, and 2008 (system development period) respectively.
- Debt financing is available for each scenario at approximately the same rates
  - 5.5 percent variable rate debt on 2006 borrowing
  - 6.0 percent fixed or variable rate debt on borrowing in years after 2006.
- Principal repayment in all scenarios (except for 100% Revenue) is assumed to be accomplished by the end of the average useful life of the assets developed.
- Average useful life of hardware and software assets developed in connection with the wholesale market redesign project is assumed to be four years (2009 - 2012).
- Energy consumption (MWhs) estimates are consistent with assumptions included in ERCOT's 2006 budget and fee filing package.
- The collection of a Nodal Surcharge in 2006 is assumed to begin around June 1, 2006.

## ERCOT Nodal Funding Fee Profile Comparison



Line	Scenario / Option	2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Average
1	Flat Fee	0.0661	0.0663	0.0664	0.0658	0.0660	0.0662	0.0647	0.0659
2	100% Revenue	0.1530	0.1532	0.1529	0.0000	0.0000	0.0000	0.0000	0.0656
3	50% Revenue	0.0827	0.0832	0.0832	0.0527	0.0530	0.0532	0.0530	0.0659
4	10% Revenue	0.0271	0.0269	0.0270	0.0955	0.0956	0.0956	0.0951	0.0661
5	100% Debt	0.0043	0.0122	0.0220	0.1157	0.1158	0.1159	0.1159	0.0717

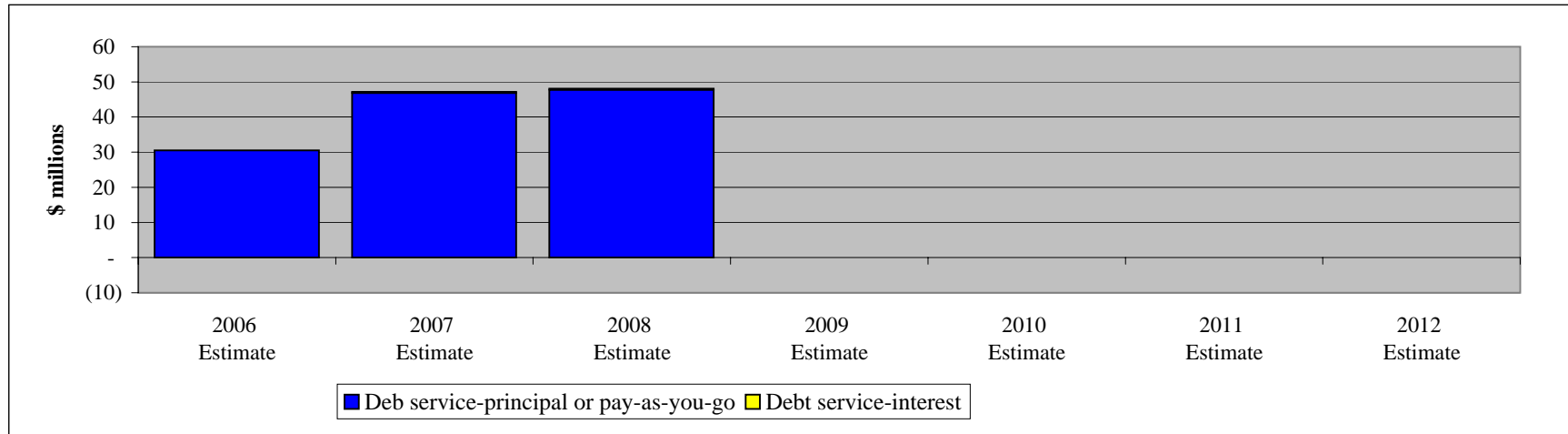
## ERCOT Nodal Funding Flat Fee



Line	(\$Millions)	2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Total or Average
1	Debt service-interest	0.5	2.3	4.1	4.1	3.1	1.9	0.6	16.6
2	Deb service-principal or pay-as-you-go	12.7	18.1	16.8	17.0	18.6	20.3	21.5	125.0
3	Total revenue requirement	13.2	20.4	20.9	21.1	21.7	22.2	22.1	141.6
4	GWh	199.3	307.8	314.5	321.4	328.2	335.4	342.1	
5	<b>Nodal Surcharge</b>	<b>\$0.0661</b>	<b>\$0.0663</b>	<b>\$0.0664</b>	<b>\$0.0658</b>	<b>\$0.0660</b>	<b>\$0.0662</b>	<b>\$0.0647</b>	<b>\$0.0659</b>
6									
7	Incremental Debt Outstanding	17.3	59.2	77.4	60.4	41.8	21.5	0.0	
8									
9	<b>(\$/MWH)</b>								
10	Debt service-interest	0.0024	0.0075	0.0130	0.0129	0.0093	0.0057	0.0019	
11	Debt service-principal or pay as you go	0.0637	0.0588	0.0534	0.0529	0.0567	0.0605	0.0628	
12	Total revenue requirement	\$0.0661	\$0.0663	\$0.0664	\$0.0658	\$0.0660	\$0.0662	\$0.0647	
13									
14									
15									
16									
17	Estimated market redesign expenditures	30.0	60.0	35.0	-	-	-	-	125.0
18	Revenue-funding for market redesign	12.7	18.1	16.8	17.0	18.6	20.3	21.5	125.0
19	Assumed incremental debt funding	17.3	41.9	18.2	(17.0)	(18.6)	(20.3)	(21.5)	-
20									
21	Cumulative incremental debt funding	17.3	59.2	77.4	60.4	41.8	21.5	-	
22	Average outstanding incremental debt	8.7	38.3	68.3	68.9	51.1	31.7	10.8	
23	Interest rate	5.50%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
24	Assumed incremental interest expense	0.5	2.3	4.1	4.1	3.1	1.9	0.6	16.6

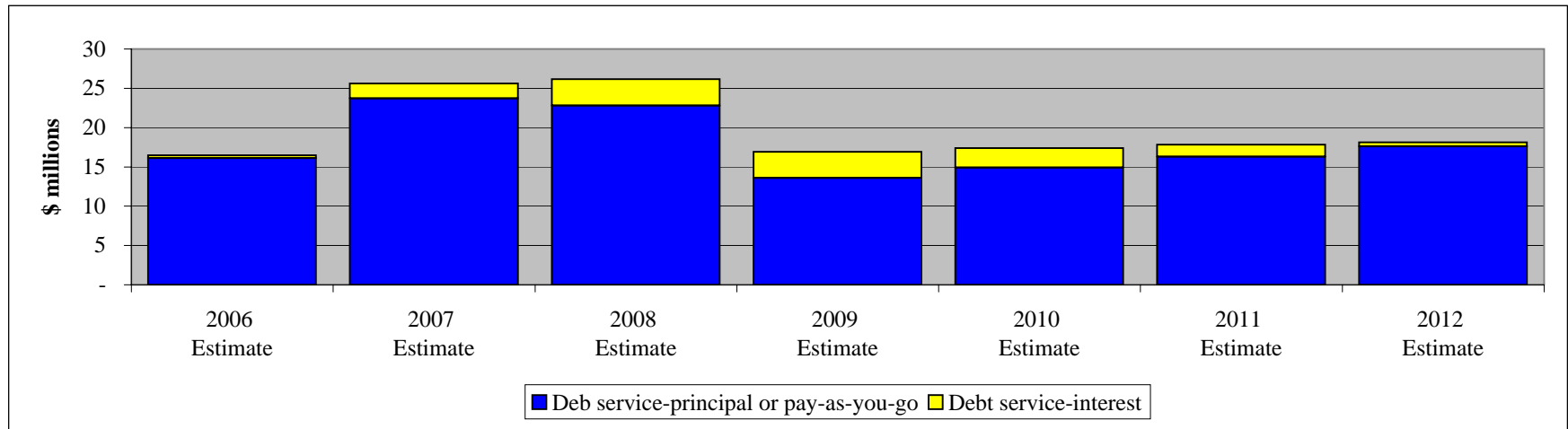


## ERCOT Nodal Funding 100% Revenue Funding



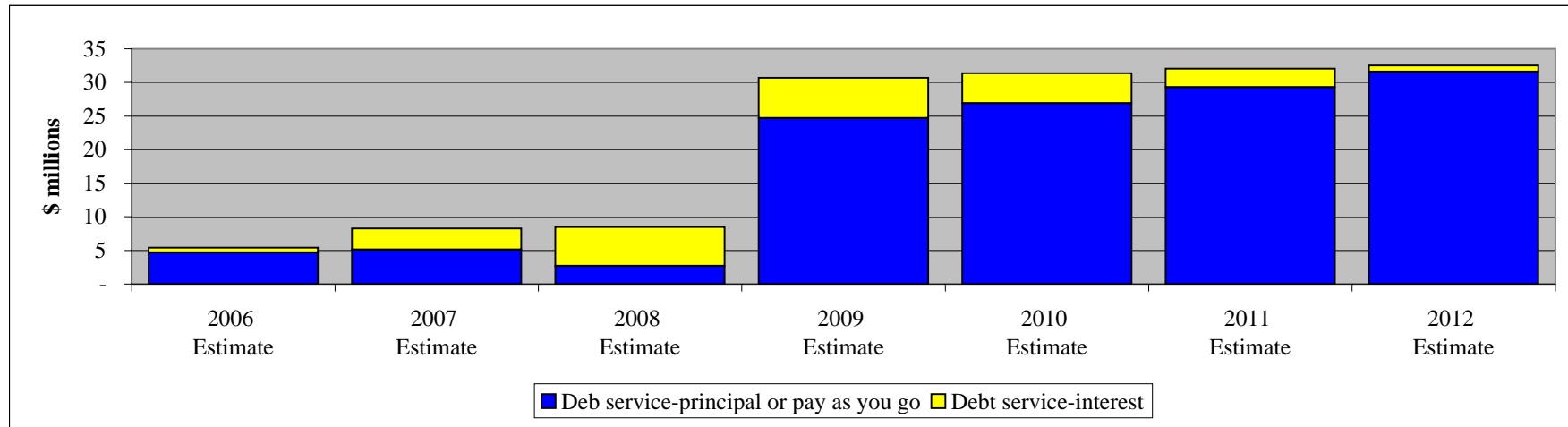
Line	(\$Millions)	2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Total or Average
1	Debt service-interest	0.0	0.4	0.4	0.0	0.0	0.0	0.0	0.7
2	Deb service-principal or pay-as-you-go	30.5	46.8	47.7					125.0
3	Total revenue requirement	30.5	47.2	48.1	0.0	0.0	0.0	0.0	125.7
4	GWh	199.3	307.8	314.5	321.4	328.2	335.4	342.1	
5	Nodal Surcharge	\$0.1530	\$0.1532	\$0.1529	\$0.0000	\$0.0000	\$0.0000	\$0.0000	\$0.0656
6									
7	Incremental Debt Outstanding	-0.5	12.7	0.0	0.0	0.0	0.0	0.0	
8									
9	(\$ / MWh)								
10	Debt service-interest	(0.0001)	0.0012	0.0012	-	-	-	-	
11	Debt service-principal or pay as you go	0.1531	0.1520	0.1517	-	-	-	-	
12	Total revenue requirement	\$0.1530	\$0.1532	\$0.1529	\$0.0000	\$0.0000	\$0.0000	\$0.0000	
13									
14									
15									
16									
17	Estimated market redesign expenditures	30.0	60.0	35.0	-	-	-	-	125.0
18	Revenue-funding for market redesign	30.5	46.8	47.7	-	-	-	-	125.0
19	Assumed incremental debt funding	(0.5)	13.2	(12.7)	-	-	-	-	-
20									
21	Cumulative incremental debt funding	(0.5)	12.7	-	-	-	-	-	
22	Average outstanding incremental debt	(0.3)	6.1	6.4	-	-	-	-	
23	Interest rate	5.50%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
24	Assumed incremental interest expense	(0.0)	0.4	0.4	-	-	-	-	0.7

## ERCOT Nodal Funding 50% Revenue Funding



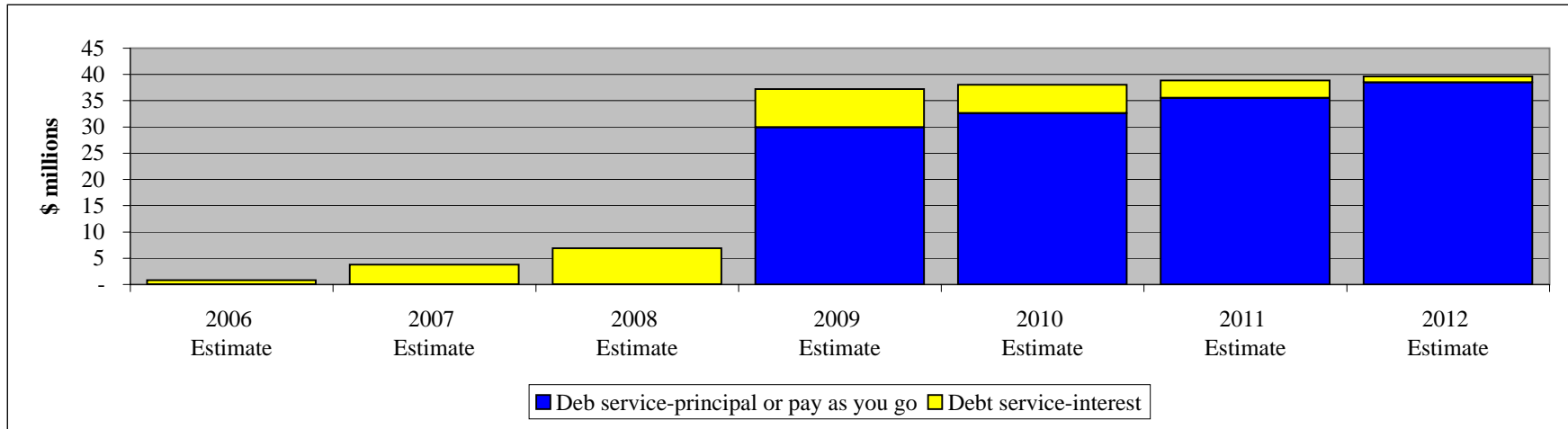
Line	(\$Millions)	2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Total or Average
1	Debt service-interest	0.4	1.9	3.4	3.3	2.5	1.5	0.5	13.6
2	Deb service-principal or pay-as-you-go	16.1	23.7	22.8	13.6	14.9	16.3	17.6	125.0
3	Total revenue requirement	16.5	25.6	26.2	16.9	17.4	17.8	18.1	138.6
4	GWh	199.3	307.8	314.5	321.4	328.2	335.4	342.1	
5	Nodal Surcharge	\$0.0827	\$0.0832	\$0.0832	\$0.0527	\$0.0530	\$0.0532	\$0.0530	\$0.0659
6									
7	Incremental Debt Outstanding	13.9	50.2	62.4	48.8	33.9	17.6	0.0	
8									
9	(\$/MWH)								
10	Debt service-interest	0.0019	0.0062	0.0107	0.0104	0.0076	0.0046	0.0015	
11	Debt service-principal or pay as you go	0.0808	0.0770	0.0725	0.0423	0.0454	0.0486	0.0514	
12	Total revenue requirement	\$0.0827	\$0.0832	\$0.0832	\$0.0527	\$0.0530	\$0.0532	\$0.0530	
13									
14									
15									
16		2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Total or Average
17	Estimated market redesign expenditures	30.0	60.0	35.0	-	-	-	-	125.0
18	Revenue-funding for market redesign	16.1	23.7	22.8	13.6	14.9	16.3	17.6	125.0
19	Assumed incremental debt funding	13.9	36.3	12.2	(13.6)	(14.9)	(16.3)	(17.6)	-
20									
21	Cumulative incremental debt funding	13.9	50.2	62.4	48.8	33.9	17.6	-	
22	Average outstanding incremental debt	7.0	32.1	56.3	55.6	41.4	25.8	8.8	
23	Interest rate	5.50%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
24	Assumed incremental interest expense	0.3823	1.9230	3.3780	3.3360	2.4810	1.5450	0.5280	13.6

## ERCOT Nodal Funding 10% Revenue Funding



Line	(\$Millions)	2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Total or Average
1	Debt service-interest	0.7	3.2	5.8	6.0	4.5	2.8	0.9	23.8
2	Deb service-principal or pay as you go	4.7	5.1	2.7	24.7	26.9	29.3	31.6	125.0
3	Total revenue requirement	5.4	8.3	8.5	30.7	31.4	32.1	32.5	148.8
4	GWh	199.3	307.8	314.5	321.4	328.2	335.4	342.1	
5	Nodal Surcharge	\$0.0271	\$0.0269	\$0.0270	\$0.0955	\$0.0956	\$0.0956	\$0.0951	\$0.0661
6									
7	Incremental Debt Outstanding	25.3	80.2	112.5	87.8	60.9	31.6	0.0	
8									
9	(\$/MWH)								
10	Debt service-interest	0.0035	0.0103	0.0184	0.0187	0.0136	0.0083	0.0028	
11	Deb service-principal or pay as you go	0.0236	0.0166	0.0086	0.0769	0.0820	0.0874	0.0924	
12	Total revenue requirement	\$0.0271	\$0.0269	\$0.0270	\$0.0955	\$0.0956	\$0.0956	\$0.0951	
13									
14									
15									
16									
17	Estimated market redesign expenditures	30.0	60.0	35.0	-	-	-	-	125.0
18	Revenue-funding for market redesign	4.7	5.1	2.7	24.7	26.9	29.3	31.6	125.0
19	Assumed incremental debt funding	25.3	54.9	32.3	(24.7)	(26.9)	(29.3)	(31.6)	-
20									
21	Cumulative incremental debt funding	25.3	80.2	112.5	87.8	60.9	31.6	-	
22	Average outstanding incremental debt	12.7	52.8	96.4	100.2	74.4	46.3	15.8	
23	Interest rate	5.50%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
24	Assumed incremental interest expense	0.7	3.2	5.8	6.0	4.5	2.8	0.9	23.8

## ERCOT Nodal Funding 100% Debt Funding



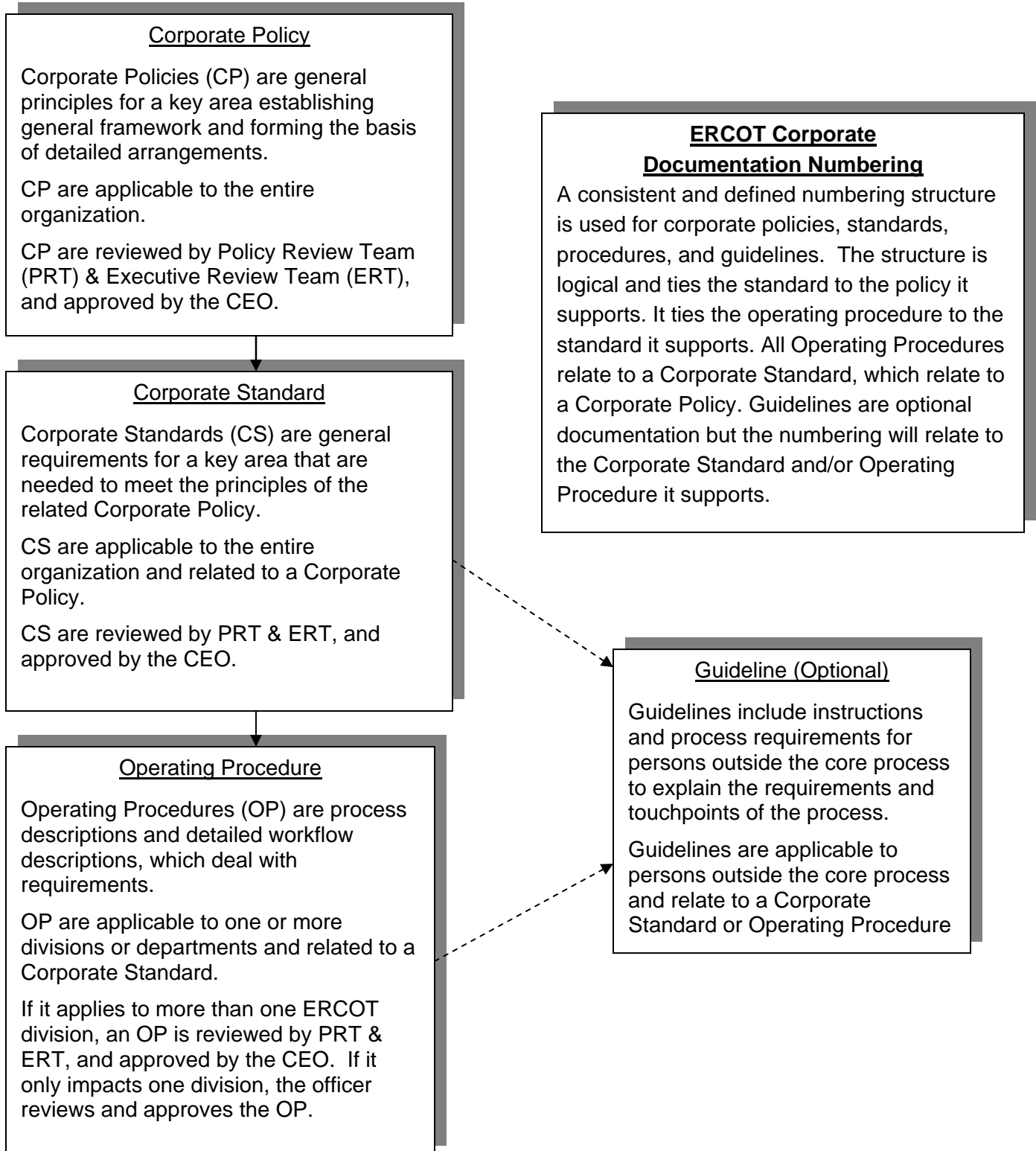
Line	(\$Millions)	2006 Estimate	2007 Estimate	2008 Estimate	2009 Estimate	2010 Estimate	2011 Estimate	2012 Estimate	Total or Average
1	Debt service-interest	0.8	3.8	6.9	7.3	5.4	3.4	1.2	28.8
2	Deb service-principal or pay as you go	0.0	0.0	0.0	29.9	32.6	35.5	38.5	136.5
3	Total revenue requirement	0.8	3.8	6.9	37.2	38.0	38.9	39.7	165.3
4	GWh	199.3	307.8	314.5	321.4	328.2	335.4	342.1	
5	Nodal Surcharge	\$0.0043	\$0.0122	\$0.0220	\$0.1157	\$0.1158	\$0.1159	\$0.1159	\$0.0717
6									
7	Incremental Debt Outstanding	30.8	94.6	136.5	106.6	74.0	38.5	0.0	
8									
9	(\$ / MWH)								
10	Debt service-interest	0.0043	0.0122	0.0220	0.0227	0.0165	0.0101	0.0034	
11	Deb service-principal or pay as you go	-	-	-	0.0930	0.0993	0.1058	0.1125	
12	Total revenue requirement	\$0.0043	\$0.0122	\$0.0220	\$0.1157	\$0.1158	\$0.1159	\$0.1159	
13									
14									
15									
16									
17	Estimated market redesign expenditures	30.0	60.0	35.0	-	-	-	-	125.0
18	Revenue-funding for market redesign	(0.8)	(3.8)	(6.9)	29.9	32.6	35.5	38.5	125.0
19	Assumed incremental debt funding	30.8	63.8	41.9	(29.9)	(32.6)	(35.5)	(38.5)	-
20									
21	Cumulative incremental debt funding	30.8	94.6	136.5	106.6	74.0	38.5	-	
22	Average outstanding incremental debt	15.4	62.7	115.6	121.6	90.3	56.3	19.3	
23	Interest rate	5.50%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	
24	Assumed incremental interest expense	0.8	3.8	6.9	7.3	5.4	3.4	1.2	28.8

- In response to audit findings, ERCOT implemented a formal document management program and adopted a framework for Corporate Policies and supporting documents
  - Previously, approved documentation was managed by each business division/unit, but no centralized framework or standard approval process existed
  - Consequently, approved policies were not readily accessible by all ERCOT staff
- Approval Process
  - Policy Review Team – Team of Directors that conduct initial review of Corporate Policies, Corporate Standards, and any Operating Procedures that impact more than one ERCOT division. PRT makes a recommendation to the executives regarding approval of a document.
  - Executive Review Team – Team of Officers that conduct second review of documents recommended by PRT. ERT makes a recommendation to the CEO regarding approval of documents.
  - Division Officer – Operating Procedures that only impact one division are approved by the officer responsible for the division.

- Current Framework (see following outline)
  - Corporate Policies
  - Corporate Standards
  - Operating Procedures
- Documents currently approved by BoD Committees
  - The Financial Policy and Investment Policy approved by F&A in November 2005 are currently related to Corporate Policy 3, Business Operations
  - The Variable Compensation Operating Procedure approved by HR & Governance Committee in January is currently related to the Human Resources Corporate Standard, which is related to Corporate Policy 5, Employment

## ERCOT GUIDELINE

### GL 1.1.1, Corporate Documentation Structure



**ERCOT Corporate Documents – Working List Printed 3/14/06**

CP – Corporate Policy

CS – Corporate Standard

OP – Operating Procedure

Approved → by final reviewer

Int Review → initial review

Fin Review → final review

In Draft → written not reviewed

**DOCUMENTS**

		Current Status	Initial Review	Final Review	Effective Date
CP1	Corporate Governance Policy	Approved	Shellman	PRT/ERT	10/25/05
CS1.1	Standard for Creation, Mod & Approval of Docs	Approved	Moseley/Byone	PRT/ERT	10/04/05
	OP1.1.1 Corporate Documentation	In Draft	Moseley/Byone	Byone	
	OP1.1.2 PRT and ERT Procedures	In Draft	Moseley/Byone	Byone	
CS1.2	Contract Approval Standard	Approved	Vincent/Shellman	PRT/ERT	10/25/05
	OP1.2.1 Vendor Contract Approval	Approved	Berinsky	PRT/ERT	3/6/06
CS1.3	Enterprise Risk Management Standard	Approved	Meek/ Byone	PRT/ERT	10/04/05
CS1.4	Fraud Prevention Standard	PRT Review	Shellman	PRT/ERT	
CS1.5	Delegation of Authority	Approved	Petterson/Byone	BOD	4/1/06
CS1.6	Internal Control	In Draft	Moseley/Byone	Byone	
	OP1.6.1 ICR Process	In Draft	Moseley/Byone	Byone	
CP2	Asset Policy	Approved	PRT	PRT/ERT	10/25/05
CS2.1	Procurement Standard	ERT Review	Yager/Byone	PRT/ERT	
	OP2.1.1 Vendor Qualification	Approved	Yager	PRT/ERT	2/27/06
	OP2.1.2 Vendor Assessment	Approved	Yager	PRT/ERT	3/6/06
	OP2.1.3 Purchase Order	Approved	Yager	Byone	2/23/06
	OP2.1.4 Receiving	Approved	Yager/ McCutchen	Byone/ Hinsley	12/09/05
	OP2.1.5 Competitive Process	ERT Review	Yager	PRT/ERT	
	OP2.1.6 Reviews	Fin Review	Berinsky	Byone	
	OP2.1.7 Payment Issue Resolution	Approved	Yager	Byone	12/09/05
CS2.2	Capitalized Assets Standard	Approved	Petterson/Byone	PRT/ERT	01/04/06
	OP2.2.1 Capitalized Assets	Approved	Naizer/Petterson	Byone	3/6/06
CS2.3	Program Management Standard	Fin Review	Connell	PRT/ERT	
CP3	Business Operations Policy	Approved	Byone	PRT/ERT	10/25/05
CS3.1	Financial Policy	Approved	Yager/Byone	F&A Approved	11/15/05
CS3.2	Investment Policy	Approved	Yager/Byone	F&A Approved	11/15/05
CS3.3	Accounting Standard	Approved	Petterson	Byone	2/17/06
	OP3.3.1 Qualified Vendor File Operating Procedure	Approved	Petterson	Byone	12/13/05
	OP3.3.2 Accounts Payable	Approved	Petterson	Byone	2/08/06
	OP3.3.3 Accounts Receivable	Approved	Petterson	Byone	3/6/06
	OP3.3.4 Financial Reports & Procedures	Approved	Petterson	Byone	3/6/06
	OP3.3.5 Journal Entry Procedure	Approved	Petterson	Byone	12/13/05
	OP3.3.6 Budget	Approved	Petterson	Byone	3/6/06



DOCUMENTS		Current Status	Initial Review	Final Review	Effective Date
	OP3.3.7   Tax Management	Fin Review	Petterson	Byone	
	OP3.3.8   Payroll Processing**	Approved	Petterson	Byone	3/6/06
CS3.4	Treasury Standard	ERT Review	Yager/ Byone	PRT/ERT	
	OP3.4.1 Treasury Operating Procedure	In Draft			
CP4	Compliance Policy	Approved	Shellman	PRT/ERT	10/25/05
CP5	Employment Policy	Approved	McIntire	PRT/ERT	10/25/05
CS5.1	Human Resources Standard	Approved	McIntire	PRT/ERT	02/13/06
	OP5.1.1   Hiring	Approved	Adams	PRT/ERT	02/13/06
	OP5.1.2   Employee Termination	Approved	Adams	PRT/ERT	02/13/06
	OP5.1.3   Employee Benefits	Int Review	Manske	PRT/ERT	
	OP5.1.4   Employee Comp & Salary Admin	Int Review	Manske	McIntire	
	OP5.1.5   Variable Compensation Plan	Approved	McIntire/Schrader	BOD	1/17/06
CP6	Information Protection Policy	Approved	Brenton	PRT/ERT	02/17/06
CS6.1	***Information Classification	In Draft	Vincent/Delenela	PRT/ERT	
	OP6.1.1   Information	In Draft	Vincent/Delenela	PRT/ERT	
CS6.2	Records Management & Retention Standard	ERT Review	Vincent	PRT/ERT	
	OP6.2.1   Records Retention	In Draft	Vincent	Shellman	
CS6.3	Wireless Device Standard	ERT Review v2	D. Johnson	PRT/ERT	
	OP6.3.1   Wireless Device Operating Procedure	ERT Review v2	D. Johnson	PRT/ERT	
CP7	Physical Security Policy	In Draft	Brenton	PRT/ERT	
CP8	Information Technology Policy	In Draft	Hinsley	PRT/ERT	
CS8.1	System Development and Maintenance	In Draft	Hinsley	PRT/ERT	
	OP8.1.1   Lawson Dev & Maintenance	Approved	McDonald/Petoskey	Hinsley	12/16/05
CS8.2	Release Management Standard	Int Review v2	Odle/Johnson/Hinsley	PRT/ERT	
	OP8.2.1   Release Management	Int Review v2	Odle/Johnson	Hinsley	
CS8.3	Operations Change Control Standard	Int Review v2	Odle/Johnson/Hinsley	PRT/ERT	
	OP8.3.1   Operations Change Control	Int Review v2	Odle/Johnson	Hinsley	

## ERCOT CORPORATE POLICY

Document Name:	Corporate Governance Policy
Document ID:	Policy 1
Effective Date:	10/25/05
Policy Owner:	Carolyn Shellman
Governs:	ERCOT Personnel

The Chief Executive Officer, under the Board's supervision, conducts the general affairs of ERCOT. All employees and agents report and are responsible to the CEO.

All management, beginning with the Chief Executive Officer and the Officers of ERCOT as approved by the ERCOT Board of Directors, have all powers necessary for them to manage their respective areas of responsibility.

Personnel must comply with ERCOT Corporate Policies, Corporate Standards, and Operating Procedures. Familiarity with the policies, standards and procedures, and demonstrated knowledge of their requirements are an important part of all personnel responsibilities.

The ultimate responsibility for the content and administration of ERCOT Corporate Policies, Corporate Standards, and Operating Procedures resides with the CEO and the Officers.

All ERCOT Personnel have a responsibility to report violations of Corporate Policies, Corporate Standards, and Operating Procedures to their immediate supervisor. Members of management, upon receiving such a report, are responsible for taking such prompt action as is appropriate to the violation being reported.

Failure to comply with Corporate Policies, Corporate Standards, and Operating Procedures, or a willful breach of such, may result in immediate disciplinary action, which may include termination. In addition, ERCOT may, at its sole discretion, pursue any and all legal remedies that may be available to it under federal or state laws, rules, or regulations.

Approved: Tom Schrader, CEO

Date: October 25, 2005

## ERCOT CORPORATE POLICY

Document Name:	Assets Policy
Document ID:	Policy 2
Effective Date:	10/25/05
Policy Owner:	Steve Byone
Governs:	ERCOT Personnel

ERCOT is committed to the cost-effective use of resources to achieve our objectives.

When purchasing equipment, supplies, materials, and services, ERCOT employees must be fair and strive for the best overall value for ERCOT while complying with ERCOT Contract, Purchasing and other policies, standards and procedures. Procurement activities must be conducted in an open and fair manner with equal opportunity provided to all qualified bidders.

Safeguarding and handling of assets including buildings, furniture, work equipment, computing equipment and software is of paramount importance to cost-effective operation. Each asset groups unique requirements for use, maintenance, safeguarding, and handling must be followed to provide the greatest benefit to the organization.

ERCOT will maintain accurate and complete records of the purchase, receipt and depreciation of capital assets for financial and management reporting purposes.

Approved: Tom Schrader, CEO

Date: October 25, 2005

## ERCOT CORPORATE POLICY

Document Name:	Business Operation Policy
Document ID:	CP 3
Effective Date:	10/25/05
Policy Owner:	Steve Byone
Governs:	ERCOT Personnel

All ERCOT employees must conduct themselves in a manner consistent with sound business and ethical practices; public interest must be paramount in all ERCOT actions; even the appearance of impropriety must be avoided to ensure and maintain public confidence in ERCOT; and all ERCOT decision making must be fair, independent, and impartial.

ERCOT is committed to maintaining a level of operating performance that meets or exceeds our responsibilities as defined by NERC, the Texas Legislature, the Public Utility Commission of Texas and the ERCOT Protocols. ERCOT maintains insurance, plans and resources to ensure continuity of operations in the case of a disaster.

Approved: \_\_\_\_\_

Date: \_\_\_\_\_

## ERCOT CORPORATE POLICY

Document Name:	Compliance Policy
Document ID:	Policy 4
Effective Date:	10/25/05
Policy Owner:	Carolyn Shellman
Governs:	ERCOT Personnel

ERCOT is committed to conducting its activities in full compliance with NERC and FERC regulations, federal and Texas law, PUCT rules and the ERCOT Protocols. Therefore, each employee will fully comply with all applicable laws and regulations.

Approved: Tom Schrader, CEO

Date: October 25, 2005

## ERCOT CORPORATE POLICY

Document Name:	Employment Policy
Document ID:	Policy 5
Effective Date:	10/25/05
Policy Owner:	Nancy McIntire
Governs:	ERCOT Personnel

ERCOT is committed to providing a work environment that attracts, motivates and retains high-quality employees. All employment applicants will be considered on the basis of individual qualifications with emphasis on selecting the best qualified person for the job. Employment with ERCOT is at will. It is for no definite period and employees may be terminated at any time without prior notice. ERCOT will comply with applicable federal and state wage and hour laws. ERCOT is committed to providing a work atmosphere conducive to productivity and professional fulfillment. This includes an environment free from all forms of discrimination; including sexual harassment, which is a criminal offense. ERCOT is committed to providing an alcohol and drug free work place.

Employees of ERCOT must conduct ERCOT's business legally, with integrity and total objectivity, and in compliance with all laws, rules, regulations, ERCOT Protocols and ERCOT policies and procedures. ERCOT will not tolerate fraud, misconduct or abuse of the Ethics Agreement or Code of Conduct. Failure to comply may result in disciplinary action, termination, injunction, and/or all other available legal or equitable remedies.

Approved: Tom Schrader, CEO

Date: October 25, 2005

## ERCOT CORPORATE POLICY

Document Name:	Information Protection Policy
Document ID:	CP 6
Effective Date:	2/13/06
Policy Owner:	Ron Hinsley / Jim Brenton
Governs:	ERCOT Personnel

ERCOT's ability to fulfill its responsibilities is predicated on the confidence of its stakeholders. Proper handling of ERCOT and stakeholder information ("Information") is essential to maintaining this confidence and is critical to the ongoing success of ERCOT as an Independent System Operator and Regional Transmission Organization.

ERCOT's policy is to provide for the confidentiality and integrity of all Information with which it is entrusted and to ensure the availability and protection of business data and technology infrastructure to stakeholders in accordance with industry standards and appropriate use of best practices to meet regulatory, contractual, and legal obligations.

ERCOT's management recognizes the sensitive nature of the intellectual property, business information, and market participant information with which it has been entrusted. ERCOT will ensure that appropriate controls and risk mitigation measures are implemented to mitigate risks to an acceptable level and provide for the recoverability of business data and protection of the technology infrastructure.

All ERCOT employees, contractors, and others who are authorized to access business data and the technology infrastructure:

- Will be granted access to Information on a need-to-know basis;
- Will be granted access to Information only to carry out assigned tasks;
- Must protect the Information to which they are granted access; and,
- Must first receive training related to the protection of business data and the technology infrastructure before being granted access and thereafter on an annual basis while at ERCOT.

Approved: Tom Schrader, CEO

Date: February 13, 2006



# **Corporate Policy 9 Security Extracts Human Resources Policy**

**Date Issued: 2/13/2006**

**ERCOT Limited**

**Restriction Notice:** This document contains information sensitive to ERCOT and should be used for internal purposes only. Any use, copying, or distribution of this information without prior written consent is specifically prohibited.



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## **1. Review and Approval**

This policy has been reviewed by the Executive Review Team and the Chief Executive Office on Monday, February 13, 2006 and is hereby approved for immediate implementation.

---

## **2. Purpose**

This document augments the policies for Human Resources that ERCOT utilizes in the hiring and training of employees and/or the engagement of contractors and/or consultants. The actual procedures provide more detail on implementation of this policy and may contain more stringent standards than this policy recommends.

## **3. Scope**

This policy applies to all potential new hires (full or part time employees, interns) and contractors and/or consultants.

## **4. Personnel Risk Assessment**

All potential new hires shall receive a background/drug screening prior to receiving electronic or physical access to critical cyber assets. Offers are made contingent upon results of the background and drug screening and may be rescinded if issues are identified.

### ***4.1 Background Screening Policy- Employees***

Human resources shall retain the background screening results in the employees' file for a minimum of at least 3 years.

The background screening includes the following:

- Criminal record check
- Credit check (consistent with the degree of access)
- Employment history verification
- Education verification
- Social Security Number verification
- Driving record
- Reference checks

### ***4.2 Drug Screening Policy- Employees***

Human resources shall retain the drug screening results in the employees' file for a minimum of at least 3 years. The Drug screening consists of a clean, supervised five-panel screen to detect cocaine, amphetamines, opiates, phencyclidine and marijuana ("Drug Screen") facilitated by a medical office or drug testing service acceptable to ERCOT.

### **4.3 Background/Drug Screening Policy- Contractor/Consultants**

Any person (Individual) who performs Services for ERCOT which require either unescorted or “badged” access to ERCOT’s facilities or access to ERCOT’s information systems or networks (“Unescorted Access”) must first successfully pass a Background Investigation and Drug Screening. The vendor company employer of the Individual (“Contractor”) must obtain consent from the Individual to perform the Background Investigation and provide the results of the Background Investigation and Drug Screening to ERCOT. Contractor must then provide the Background Investigation and Drug Screening results to ERCOT before any Individual may be authorized to perform Services with Unescorted Access.

The Background Investigation and Drug Screening must include:

1. A criminal background check, in each county, state, and country in which the Individual lived, worked, or attended school for at least the past 10 years, showing no felonies and no misdemeanors except those misdemeanors that ERCOT accepts in writing, using a vendor of consumer report services acceptable to ERCOT;
2. A verification of Individual’s prior employment and educational history by Contractor or by a consumer report service acceptable to ERCOT;
3. A check of Individual’s driving history if driving is required for the performance of Services, by a consumer report service; and
4. A clean supervised five-panel drug screen to detect cocaine, amphetamines, opiates, phencyclidine and marijuana (“Drug Screen”), by a medical office or drug testing service acceptable to ERCOT.

ERCOT must be provided the following documents (by faxing them to 512-248-3176), confirming the Background Investigation results:

1. A listing, signed by the Individual, of the countries, states, and counties in which Individual has lived, worked, or attended school for at least the past 10 years (or to the age of 17, if less than 10 years);
2. Written results of the criminal investigation, from the consumer report service;
3. Written confirmation of Individual’s education and employment history;
4. Written results of the Drug Screen, from the medical facility or drug testing lab.

All Individuals who provide Services for ERCOT must abide by ERCOT’s Code of Conduct and policies and procedures applicable to ERCOT independent contractors. Such Individuals shall execute the then-current form of confidentiality, non-conflict, ethics, electronic resource use, and antitrust agreements required by ERCOT prior to their entering ERCOT premises, using ERCOT equipment or networks, or beginning services for ERCOT.

Results of Background/Drug Screening for Contractors and Consultants will be retained by the Legal department for period of 3 years.

## 5. HR Recruiting and Hiring

### 5.1 Scope

Effective recruitment, interviewing and selection of qualified individuals for our staffing needs are essential to accomplishing our corporate objectives. Detailed procedures have been established to ensure we have legally sound and effective hiring practices. When filling a position with a regular, ERCOT employee, these steps must be followed. The detailed procedures cover the recruiting and hiring process of all full-time employee, intern, and contractor/consultant job applicants. Human Resources will maintain documentation for all employees.

### 5.2 Procedure Review / Update Triggers

HR Recruiting and Hiring procedures are reviewed annually for consistency and compliance.

## 6. Employee Training

### 6.1 Statement of Intent and Background

The intent is to identify all the interdepartmental responsible parties and process steps required to qualify, validate, and train ERCOT FTE's, interns, and/or contractors/consultants who will be provided access to critical cyber assets. The detailed procedures will ensure that ERCOT meets all of the NERC 1207 and 1211 requirements to screen, approve, and train personnel and maintain current records of all personnel who are required to have access to critical cyber assets.

### 6.2 New Employee Orientation

All new employees are required to attend New Employee Orientation sessions. These sessions are scheduled to occur every other Monday each month. New employees who have start dates not coinciding with scheduled New Employee Orientation session are required to attend the session next scheduled New Employee Orientation. Contractors, interns, consultants are also required to attend these sessions to ensure they have completed NERC Cyber Security Training.

New Employee Orientation shall consist of:

- Basic computer orientation by IT Dept.
- Physical Security Training
- Cyber Security Awareness Training
- NERC Cyber Security Training
- Acceptable Use Policy
- Employee Handbook - policies and procedures
- Benefits explanation and enrollment
- New Hire paperwork

### **6.3 NERC Cyber Security Training**

All employees, contractors, interns, consultants shall be trained commensurate with their access to critical cyber assets prior to receiving electronic or physical access to these assets. They shall also have their training reviewed/be re-certified on an annual basis.

NERC Cyber Security Training shall consist of:

- The Cyber Security Policy
- Physical and electronic access controls to critical cyber assets
- The proper release of critical cyber asset information
- Potential threat incident reporting
- The action plans and procedures to recover or re-establish critical cyber assets and access thereto following a cyber security incident

ISSD will administer the training and the quiz at this time. This is to train those FTE's, interns, and/or contractors/consultants that shall have access to critical cyber assets in the future due to additional job duties or departmental transfers.

ISSD will provide the results and a copy of the quiz to HR for Employees, Legal for contractors/consultants and a copy of all results to the ERCOT NERC Compliance Monitor. ISSD will maintain the quiz results for a minimum of 3 years.

ISSD will complete an annual training program review and a completion record for each employee and contractor to be provided to the NERC Compliance Monitor, who will in turn send the same to the External NERC Compliance Monitor. Audit data from these reviews shall be kept for a minimum of three years.

### **6.4 Training Attendance & Completion Tracking**

Human Resources shall track attendance for the New Hire Training. These documents will be retained for a minimum of 3 years.

## **7. CCA User List**

A listing of all FTE's, interns, and/or contractors/consultants having electronic and/or physical access to critical cyber assets shall be maintained via the Intranet by the System Engineering and Administration Dept. This listing shall be updated within 24 hours of any change and shall be reviewed on a quarterly basis. Changes are identified as: new FTE's; interns; and/or contractors/consultants, departmental transfers and terminations/contract expirations. The System Engineering and Administration Department shall produce reports upon request. Revisions to the CCA list including change requests shall be maintained for 3 years by the System Engineering and Administration Dept.

FTE's, interns, and/or contractors/consultants shall be removed from the Critical Cyber Assets Users List via the Intranet database within 24-hours of termination.

## **8. Policy Review and Compliance Checks**

ERCOT shall review and update this document as necessary and at least annually.

ERCOT shall demonstrate compliance through self-certification submitted to the compliance monitor annually. The compliance monitor may also use scheduled on-site reviews every three years, and investigations upon complaint, to assess performance. Audit data from these reviews shall be kept for a minimum of three years.

At any time of a review or audit, the following data will be required:

- Access to this document
- Access to past audit logs
- Access to Self-Certification documents
- Verification that these policies are being followed

## **9. Enforcement**

Any employee found to have violated these policies may be subject to disciplinary action, up to and including termination of employment.

## **10. Definitions**

CCA	Critical Cyber Asset
FTE	Full Time Employee

## 2006 YTD Project Performance

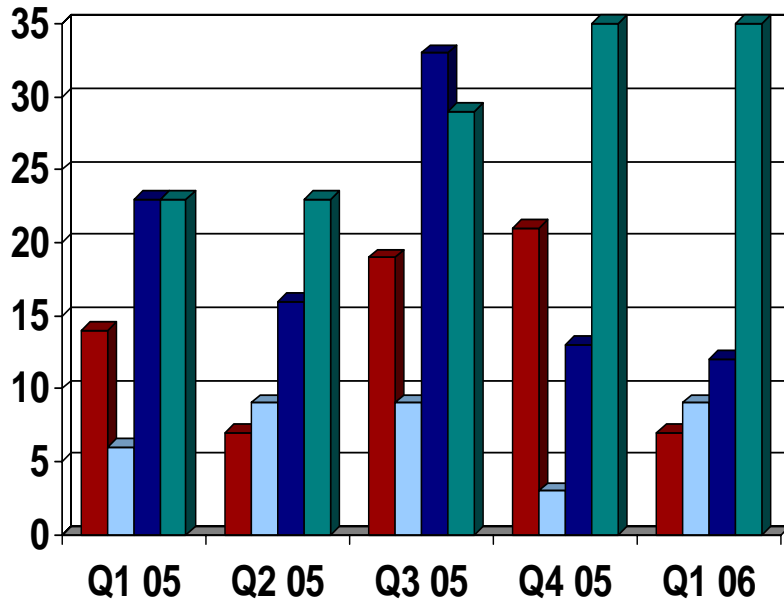
### First Quarter Results (to 2/28/06)

- 4 completed in Feb, 7 YTD
- 9 in Initiation
- 12 in Planning
- 35 in Execution

### Projects Completed in February

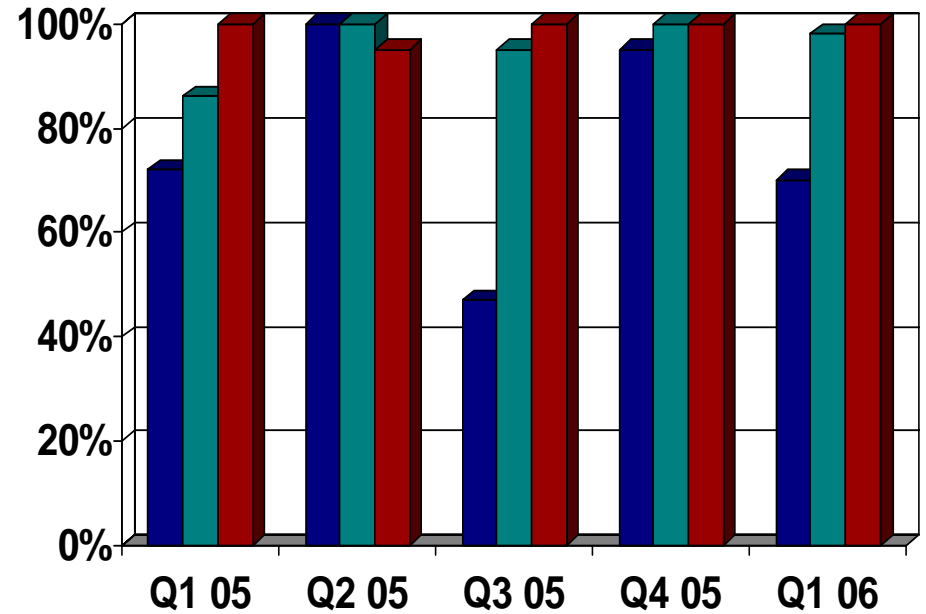
- PR-50136 EMMS Upgrade of OSI PI and OAG
- PR-40100 RTCA Archiving
- PR-40098 Performance Monitoring for SCADA/State Estimator
- PR- 50125 Production Storage

### Project Activity



■ Completed ■ Initiation ■ Planning ■ Execution











### Project Performance



■ On Time ■ On Budget ■ Deliverables



# Large Projects Summary

Project	Total Budget	Actual 02/28/06	Metrics	
			 Schedule	 Budget
<i>Duration/Information (Sponsor)</i>	<i>Phase/Scheduled Completion</i>			
<b>Service Oriented Architecture (2004-2006)</b>	<b>\$6.1M</b>	<b>\$5.6M</b>		
<i>3 separate projects over 12 mos. (R Giuliani)</i>	<i>Execution Phase/4th Qtr 2006</i>			
<b>Enterprise Data Warehouse (2003-2006)</b>	<b>\$3.5M</b>	<b>\$2.6M</b>		
<i>9 separate projects over 36+ mos. (R. Hinsley)</i>	<i>Execution Phase/3<sup>rd</sup> Qtr 2006</i>			
<b>Operations Training Simulator (2005-2006)</b>	<b>\$3.4M</b>	<b>\$199K</b>		
<i>Training Simulator System for Operators (S Jones)</i>	<i>Planning Phase/4th Qtr 2006</i>			
<b>Enhancements to FasTrak Tools</b>	<b>\$2.5M</b>	<b>\$977K</b>		
<i>Tool for Tracking Market Issues (R Giuliani)</i>	<i>Execution Phase/3<sup>rd</sup> Qtr 2006</i>			
<b>Enhancements to SCR727 (2005-2006)</b>	<b>\$1.9M</b>	<b>\$358K</b>		
<i>Preliminary Planning over 12 mos. (R Giuliani)</i>	<i>Planning Phase/2<sup>nd</sup> Qtr 2006</i>			

## Project Performance by Program Area

### ACTIVE & PROJECTED PORTFOLIO

	Initiation	Planning	Execution	Total Active	On Time	On Budget	% On Time	% On Budget
<b>CO</b>	4	4	6	14	10	14	71.4%	100.0%
<b>IO</b>	1	1	5	7	6	7	85.7%	100.0%
<b>MO</b>	0	0	11	11	7	10	63.6%	90.9%
<b>RO</b>	0	3	3	6	4	6	66.7%	100.0%
<b>SO</b>	2	4	10	16	10	16	62.5%	100.0%
<b>NODAL</b>	2	0	0	2	2	2	100.0%	100.0%
<b>Totals</b>	<b>9</b>	<b>12</b>	<b>35</b>	<b>56</b>	<b>39</b>	<b>55</b>	<b>70.0%</b>	<b>98.2%</b>

## Large Project Update

### IT Operations Program Area

- PR-40070 Austin Test Environment
  - Project in planning ready to move to execution
  - Project now over \$1M requesting approval to go execution
  - Resolution will be presented for Board approval
- PR-50078 ERCOT Network Replacement
  - Project executing final contracts have taken 5 months
  - Need budget increase, resolution will be presented for Board approval
- PR-60011 TCC Data Center Optimization (formerly Virtualization)
  - Project to move into planning in support of Infrastructure Capacity
  - On the approved PPL, within capability, over \$1M
  - Presented as information only, will return for execution approval
- Corporate Operations Program Area
- PR 60078 Taylor Facilities Build for Nodal
  - Project to finish out Taylor space required for Nodal teams
  - Forecasted Nodal needs exceed available space starting in May
  - Project evaluates leasing and Taylor Facilities build out options
  - Resolution will be presented for Board approval

*Data Unavailable*

- Credit Working Group reviewed the charter and does not have any changes to propose at this time
  - Comments, questions or changes from F&A?
  
- Credit Working Group has nominated a Chairman
  - Comments or questions from F&A?
  
- F&A Committee to:
  - Ratify the Credit Working Group Charter
  - Confirm the Chairman of the Credit Working Group



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

### **ERCOT Credit Work Group Charter**

#### **I. Purpose and Authority**

The Electric Reliability Council of Texas, Inc (ERCOT) Board of Directors established the ERCOT Credit Work Group (CWG) as a group of credit professionals to help ensure that appropriate procedures are implemented to mitigate credit risk in the ERCOT Region in a manner that is fair and equitable to all market participants.

The CWG will review all sections of the ERCOT Protocols that impact creditworthiness requirements or collateral calculation and provide recommendations to the Finance and Audit Committee of the Board. When possible, the CWG will provide comments to ERCOT TAC subcommittees when Protocol Revision Requests (PRRs) or other actions have credit implications.

#### **II. Reporting Relationships**

- The CWG reports to the Finance and Audit Committee of the Board.

#### **III. ERCOT Credit Work Group Functions**

The functions of the work group include, but are not limited to:

- Providing policy input to PRRs that impact credit
- Providing input to the Creditworthiness Standards

In addition, the group may, from time to time, make recommendations to existing or proposed systems, projects, plans, Protocols and policies and procedures of the Company impacting credit issues.

The CWG shall not engage in any activities that are in conflict with or that violate ERCOT's Protocols and/or Ethics Agreement.

The CWG will at all times comply with the Antitrust Guidelines for Members of ERCOT Committees, Subcommittees and Working Groups.

The CWG shall not have direct responsibility or authority over ERCOT staff. Although the CWG will recommend courses of action, the responsibility for implementation of policy or procedures shall rest with ERCOT Staff.

In carrying out its responsibilities, the CWG shall be guided by industry best practices.

#### **IV. Credit Work Group Administration**

The Chairman of the CWG will be nominated annually by the membership of the CWG and confirmed by vote of the Finance and Audit Committee in March of each year.

The CWG will meet at least quarterly to review credit policy. In addition, they will meet as needed to address issues as they arise or Protocol revisions as they are proposed or needed. All meetings will be posted on the ERCOT website and are open for interested parties to attend and participate in discussions.

Each Market Participant may but is not required to have one designated voting member on the CWG. The Market Participant may appoint an alternate for the designated voting member. Any member of the CWG must meet the qualifications as identified on the attached Qualifications Guidelines for Credit Work Group Membership. The Finance and Audit Committee will review the requirements for membership in the CWG annually.

Each member of the Committee shall have one vote.

While the CWG will provide a recommendation based on the majority view of the CWG to the appropriate committee, any dissenting party shall have the right to present its view to the same committee if they choose to do so.

All votes shall be made at the time of the meeting by a representative of the member's company or by proxy by another member. If the vote is going to be made by proxy, the member must ensure that the appropriate ERCOT staff has received the proxy by electronic written communication prior to the meeting.

The Chairman of the CWG will report at least semi-annually to the Finance and Audit committee as to the state of credit policy within ERCOT. In addition the Chairman of the CWG will notify the Chairman of the Finance and Audit Committee of significant issues as they arise.

This Charter will be reviewed and ratified at least annually by the Finance and Audit Committee.

**V. Additional Questions on the ERCOT Credit Work Group**

For additional questions on ERCOT's Credit Work Group and creditworthiness requirements, please contact the ERCOT Credit Manager, Vanessa Spells at (512) 225-7014 or by email at [vspells@ercot.com](mailto:vspells@ercot.com).

**Effective September 1, 2004**



## **Qualification Guidelines for Credit Work Group Membership**

CWG members must be employees of a corporate member of ERCOT in good standing and be actively engaged in or responsible for the credit activities of such corporate member. Each corporate member is limited to one voting CWG member.

CWG members must have experience in at least one or more of these fields:

- Risk management (preferably credit risk management)
- Credit management and analysis
- Development and/or execution of credit risk policies and procedures
- Establishment and control of credit limits and terms
- Administration of debt-repayment plans
- Finance and/or loan administration
- Credit ratings analysis
- Commercial credit analysis
- Financial analysis

CWG members must be active participants on the CWG.

- ❑ TAC has approved a number of Protocol changes to improve the credit profile of the market.
  
- ❑ Credit Working Group met on Feb 3 to review the changes made to date and evaluate residual risk
  - Reviewed the impacts of the various PRRs that have been implemented
  
  - Noted that “low hanging fruit” had been addressed

- Received an update on Mass Transition timeline from C Reed and C Bratton
  - ***Short term - Mass Transition timeline is not expected to change***
  - Long term – goal is to reduce Mass Transition timeline to 3-4 business days
    - ***Long term solution not expected to be effective for 12 to 18 months***
    - Requires Protocol changes, system changes, etc.
  
- CWG continues to be concerned about credit risk
  - In the interim until a long term solution is implemented
  - Residual credit risk once a solution is in place
  - ***There continues to be a significant level of credit exposure in the market that is not mitigated***

- ❑ QSEs representing their own load
  - Approx 80% of LSEs represent themselves as QSEs
    - Supported by collateral
  - Approx 20% of LSEs are represented by others
    - Supported by notice period from QSEs of intent to drop
  
- ❑ Credit quality of QSEs representing load
  - 23% of load meets credit standards
  - 41% of load does not meet credit standards and posts a guaranty
  - 36% of load does not meet credit standards and posts cash or LCs

- CWG has been meeting over the past month to consider options to “fill the gap” until the long term solution can be implemented.
  - Preferred solution – Reduce the timeframe it takes to complete a Mass Transition (earlier than 12 – 18 months)
  - Alternate solutions currently being considered
    - Provide more stringent collateral requirements for entities with weaker financials
    - Reduce the time allowed to post collateral by an additional day
    - Certification of good standing by company officer
    - Increase collateral requirements generally
    - Credit insurance

- Reduce the timeframe it takes to complete a Mass Transition (earlier than 12 – 18 months)
  - TAC has requested that RMS / Texas Set relook at timelines and see if shorter term solutions can be found
  - Preferred solution of Credit Working Group
    - Even if shorten Mass Transition timeline, there will continue to be unmitigated credit exposure in the market

- ❑ Two of the options being considered involve increasing collateral requirements in some way
  - Increases can involve doubling / quadrupling collateral requirements
  - Can have a significant cost, which can reduce an entities ability to compete in the ERCOT market
  - Most secure (other than reducing Mass Transition timeline)
- ❑ Reduce posting time by another day
  - May be pursued, however, impact is limited

- ❑ Self-certification by company officer
  - Generally – certify weekly (say Monday) for the two weeks forward (Friday to Thursday) that bilaterals are in place
    - Auditable by ERCOT
  - Potentially to be used in conjunction with higher collateral requirements
  - Concern: Doesn't have “teeth” – Not enforceable



- ❑ Credit insurance
  - Talking with a broker about options and cost
  - Need to consider how to pay for coverage
  - Market participants must give written permission to disclose proprietary information
    - Historically this has been a stumbling block
  - Would cover some but not all risk

- ❑ Substantial credit risk remains in the market related to Mass Transition events
  
- ❑ Long term solutions are 12 – 18 months away from implementation
  - Long term solutions will not fully mitigate credit exposure
  
- ❑ CWG is reviewing possible ways to mitigate credit exposure
  - Preferred solution is one that ***reduces*** credit exposure
  - Alternate means of mitigating risk are being considered

- ❑ Want to provide an environment that will support a strong market
  - Currently, goal is not to eliminate ALL credit exposure
  - Want to ensure financial viability of market

- ❑ CWG will continue to identify and work through potential solutions

**Questions ?**

# Supplemental Slides from TAC Update

**Identify problem and make collateral call** BDay 0

**Notice periods (4 BDays, down from 6)**

- ❑ Collateral due BDay 2
- ❑ Notice of default given BDay 2
- ❑ 2 BDays to cure default BDay 4

**Mass transition (9-11 BDays)**

- ❑ Conference call to begin Mass Transition BDay 5
- ❑ POLRs initiate switches (5 BDays allowed, switches to date have taken, on avg 3 BDays) BDay 8
- ❑ Time until switch complete by TDSP BDay 14

(Note: 14 business days + 6 weekend days = 20 days of liability)

Potential loss (simplified – w / **3 weeks** of collateral)

**Collateral held**

1,000 MWh/day x \$100/MWh x **10%** x **21** days = \$ 210,000

**At default**

1,000 MWh/day x \$100/MWh x **100%** x **21** days = \$ 2,100,000

**Potential loss to the market** \$ 1,890,000

For 100 MWh/day \$ 189,000

For 10,000 MWh/day \$ 18,900,000

Open question: Is 20 days a reasonable estimate if the MP is a larger entity?



Potential loss range – w/ **3 weeks** of collateral

(assume MCPE = \$100/MWh)

Collateralized based on At Default	BES 10%	BES 100%
	BES 100%	BES 100%
For 100 MWh/day	\$ 189,000	\$ 0
For 1,000 MWh/day	\$ 1,890,000	\$ 0
For 10,000 MWh/day	\$ 18,900,000	\$ 0

Potential loss range – w/ **2 weeks** of collateral

(assume MCPE = \$100/MWh)

Collateralized based on At Default	BES 10%	BES 100%
	BES 100%	BES 100%
For 100 MWh/day	\$ 196,000	\$ 70,000
For 1,000 MWh/day	\$ 1,960,000	\$ 700,000
For 10,000 MWh/day	\$ 19,600,000	\$ 7,000,000

- ❑ Consistent calculation
- ❑ Inconsistent results in terms of protection in the market

# of LSEs by average daily MWh for August 2005

<u>MWh/day</u>	<u>CR</u>	<u>NOIE</u>	<u>Tot</u>	<u>%</u>	<b>Potential</b> <u>Loss by cat</u>
< 200	23	25	48	31%	\$ 200k ea
200-2,000	21	41	62	40%	\$ 2,000k ea
2,000-20,000	24	12	36	23%	\$20,000k ea
> 20,000	<u>7</u>	<u>3</u>	<u>10</u>	<u>6%</u>	
<b>Total</b>	<b>75</b>	<b>81</b>	<b>156</b>	<b>100%</b>	

Entity	Est MWh/day	Est ESIDs	Tot Est Exposure
LSE 1	350	3,000	\$ 400,000
QSE 1	50	500	\$ 30,000
QSE 2	65	550	\$ 220,000
LSE 2	3,500	12,250	\$ 5,500,000
LSE 3	1,500	10,000	\$ 200,000
QSE 3	125	2,500	\$ 100,000
Total			\$ 6,450,000

- ❑ “Right size” collateral for the risk faced by the market
- ❑ Very costly to entities required to post
  - Potential to constrain competition in the market

***Current (estimated)***

# of days at historical usage	40	40	40	40
Historical usage	10%	100%	10%	100%
Price per MWh	\$ 50	\$ 50	\$ 50	\$ 50
MWh/day				
100	\$ 20,000	\$ 200,000	\$ 20,000	\$ 200,000
1,000	\$ 200,000	\$ 2,000,000	\$ 200,000	\$ 2,000,000
10,000	\$ 2,000,000	\$ 20,000,000	\$ 2,000,000	\$ 20,000,000

## Potential calculation

# of Days at 100%		<b>7</b>		<b>7</b>		<b>14</b>		<b>14</b>
# of Days at historical usage (Note1)		19		19		19		19
Historical usage		10%		100%		10%		100%
Price per MWh	\$	50	\$	50	\$	50	\$	50
MWh/day								
100	Historical	\$ 9,500	\$	95,000	\$	9,500	\$	95,000
	100%	\$ 35,000	\$	35,000	\$	70,000	\$	70,000
	Total	<u>\$ 44,500</u>	<u>\$</u>	<u>130,000</u>	<u>\$</u>	<u>79,500</u>	<u>\$</u>	<u>165,000</u>
1,000	Historical	\$ 95,000	\$	950,000	\$	95,000	\$	950,000
	100%	\$ 350,000	\$	350,000	\$	700,000	\$	700,000
	Total	<u>\$ 445,000</u>	<u>\$</u>	<u>1,300,000</u>	<u>\$</u>	<u>795,000</u>	<u>\$</u>	<u>1,650,000</u>
10,000	Historical	\$ 950,000	\$	9,500,000	\$	950,000	\$	9,500,000
	100%	\$ 3,500,000	\$	3,500,000	\$	7,000,000	\$	7,000,000
	Total	<u>\$ 4,450,000</u>	<u>\$</u>	<u>13,000,000</u>	<u>\$</u>	<u>7,950,000</u>	<u>\$</u>	<u>16,500,000</u>

Note 1: These days are based on: 40 days less 14 days forward less 7 days for PRR 568



## ❑ Cost Example

- For the 36% of QSEs that must post cash or LC
  - At 1 MM MWh/day of load X \$50/MWh X 7 days X 36% = \$126 MM in additional collateral to post
  - At 15% cost of capital = Approx. \$19 MM per year or 17.4 cents/MWh (\$19MM / 300,000 MWh/d / 365)
  
- For the 41% of QSEs that post a guaranty
  - At 1 mm MWh/day of load x \$50/MWh X 7 days x 41% = Approx. \$144 MM in additional guaranty support
  - At 4% imputed cost = Approx. \$6 MM

From: M. Petterson  
To: Finance and Audit Committee  
Date: March 14, 2006  
Re: Review Guidelines for engagement of external auditors for other services

### **Objective**

1. Provide recommended guidelines for ERCOT's management team and members of the Finance and Audit Committee of the Board to use when engaging external auditors for services other than audit services.

### **Recommendation**

1. ERCOT should follow the requirements established in Section 202 (see attached Exhibit 1).
2. When necessary to request preapproval from the Finance and Audit Committee for engagement of external auditors for "other services", ERCOT staff should make the request using the standard decision template (with other essential supporting documentation) used for Board and Board Committee meetings.
3. Engagements for "other services" totaling less than \$5,000 should be communicated in writing to the members of the Finance and Audit Committee at the first meeting following the engagement for the "other services" at issue. This threshold amount is well below the de minimus exceptions provided for in Section 202.
4. Amend the Charter of the Finance and Audit Committee to allow for de minimus exceptions, consistent with point 3 (above) and the requirements of Section 202.

### **Background**

1. Attached Exhibit 1 details the requirements of Section 202.
2. Attached Exhibit 2 details the language included in the charter of ERCOT's Finance and Audit Committee.

**Exhibit 1 - The Sarbanes-Oxley Act of 2002, SEC. 202.  
PREAPPROVAL REQUIREMENTS.**

(1) IN GENERAL. -

(A) AUDIT COMMITTEE ACTION. - All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

(B) DE MINIMUS EXCEPTION. - The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if -

(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the nonaudit services are provided;

(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

(2) DISCLOSURE TO INVESTORS. - Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

(3) DELEGATION AUTHORITY. - The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES. - In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection."

## **Exhibit 2 – Excerpt from the Charter of the Finance and Audit Committee of the ERCOT Board of Directors**

### **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 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

# Committee Briefing: Credit Stats

as of 01/31/2006

as of 02/28/2006

	# of QSEs*	Estimated Aggregate Liability (\$)	% of EAL	Total Unsec Credit Limit / Security Posted			# of QSEs*	Estimated Aggregate Liability (\$)	% of EAL	Total Unsec Credit Limit / Security Posted	
<b>Exposure in the ERCOT Market (owed to ERCOT)</b>											
<u><b>QSEs that meet ERCOT Creditworthiness Standards</b></u>											
Ratings over BBB-	9	17,897,890	6%	260,021,639	U		10	30,695,399	9%	274,841,374	U
<u><b>QSEs that do not meet ERCOT Creditworthiness Standards</b></u>											
Ratings below BBB- or not rated											
Cash & Letters of Credit	35	269,288,033	74%	435,906,494	S		38	209,673,076	56%	306,885,628	S
Guarantee Agreements	7	76,454,636	20%	217,700,000	S		8	134,499,990	35%	218,211,777	S
<b>Total Exposure</b>	<b>51</b>	<b>363,640,559</b>	<b>100%</b>				<b>56</b>	<b>374,868,465</b>	<b>100%</b>		
<b>Other QSEs in the ERCOT Market (ERCOT owes)</b>											
<u><b>QSEs that meet ERCOT Creditworthiness Standards</b></u>											
Ratings over BBB-	6	(2,319,205)	-4%	128,430,215	U		6	(2,016,673)	-2%	118,610,481	U
<u><b>QSEs that do not meet ERCOT Creditworthiness Standards</b></u>											
Ratings below BBB- or not rated											
Cash & Letters of Credit	42	(24,870,391)	-40%	33,063,169	S		39	(22,793,868)	-22%	61,144,549	S
Guarantee Agreements	12	(35,287,447)	-56%	152,277,000	S		13	(77,898,963)	-76%	186,277,000	S
<b>Total</b>	<b>60</b>	<b>(62,477,043)</b>	<b>-100%</b>				<b>58</b>	<b>(102,709,504)</b>	<b>-100%</b>		
<b>Total</b>	<b>111</b>						<b>114</b>				

U: Unsecured since these QSEs meet the creditworthiness standards  
S: Secured i.e. required to post collateral since these QSEs do not meet the creditworthiness standards

**ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.**  
**RISK MANAGEMENT EVENT PROFILE MATRIX (as of March 3rd, 2006)**

Strategic Position	Operational Excellence	Market Facilitation	Grid Reliability	Reporting	Compliance 70
<p> <b>Strategy Development</b>  <i>Objective setting adequately incorporates informed stakeholder input, market realities and management expertise</i></p> <p>ERCOT staff is generally not sufficiently aware of ERCOT's short or long-range strategic plan. Management is in the process of communicating to employees an ERCOT vision and the employee's role in working to achieve the vision. The uncertainty surrounding the proposed ERO environment increases risk.</p>	<p> <b>Performance Monitoring</b> </p> <p><i>Clearly defined performance metrics linked to mission and goals; actively monitored, status communicated and corrective action taken</i></p> <p>Performance monitoring tools lack desired early warning indicators and may fail to highlight potential underperforming activities</p>	<p> <b>Customer Choice</b> </p> <p><i>Market design promotes efficient choice by customers of energy providers with effective mechanisms to change incumbent market participants as desired.</i></p> <p>IT components supporting Customer Choice are currently not at the desired levels to meet SLA's. Successful replacement of SeeBeyond Application with TIBCO and Test environment build out will have a major impact on Customer Choice operations.</p>	<p> <b>Grid Operations</b></p> <p><i>Information required to operate the grid is efficiently gathered and appropriate tools are prudently configured to efficiently operate the system</i></p> <p>Current tools utilized by the System Operator (including the State Estimator and the accuracy/availability of SCADA data) and the lack of an Operator Training Simulator exposes ERCOT to greater reliability risks. Recent improvements have increased the amount and accuracy of information available for analysis.</p>	<p> <b>Review Practices</b> </p> <p><i>Prudent measures are taken to insure that company disclosures are properly vetted and not misleading</i></p> <p>Internal review standards to ensure accuracy and completeness of information prior to release are below desired levels. Board of Director's Review of management activities on an ongoing basis assists in ensuring proper review and disclosure practices.</p>	<p> <b>Legal &amp; Legislative</b></p> <p><i>Operations are conducted in compliance with all laws and regulations and current and proposed legislation are understood and communicated</i></p> <p>Failure to properly comply with laws, regulations, and protocols may result in fines, penalties, reliability degradation or other impacts. An initiative is in progress to identify key legal and regulatory requirements and ensure they are satisfied on a timely basis.</p>
<p> <b>Mission and Goals</b></p> <p><i>Corporate objectives and performance standards are understood and followed</i></p> <p>Current management initiatives related to goal setting and 'Line of Sight' have increased awareness of goals, and objectives related to high-level corporate objectives and priorities for individual divisions, departments, and employees</p>	<p> <b>Business Practices</b></p> <p><i>Business planning, processes and management standards are effective and efficient</i></p> <p>Business continuity and disaster recovery plans, record retention procedures, and safety practices are currently below desired expectations. Additional development activities required to implement and test these procedures.</p>	<p> <b>Administration</b></p> <p><i>Market rules are fairly applied to all participants</i></p> <p>No significant issues relating to administration of existing protocols have been identified.</p>	<p> <b>Planning</b></p> <p><i>Operational and long-range planning methods enable efficient responses to necessary system changes to maintain reliability standards</i></p> <p>Lack of timely and accurate information necessary to build reasonable system models and forecasts, an insufficient ability to conduct long-range (6-10 years out) planning, demands on planning resulting from a transition to Nodal, and exposure that transmission planning will receive related to the passage of SB 20 combine to create a heightened level of risks.</p>	<p> <b>Disclosure</b></p> <p><i>Reporting and other disclosures to intended parties is timely, accurate and effective</i></p> <p>A Disclosure Committee is in the process of being institutionalized to discuss and report on issues related to external reporting and compliance.</p>	<p> <b>Internal Control Compliance</b></p> <p><i>Internal Control Compliance, processes and management standards are effective and efficient</i></p> <p>Failure to comply with internal controls may lead to imprudent or unauthorized use of corporate assets and/or inaccurate Reporting. All prior audit issues are being actively tracked and monitored by management as well as Internal Audit.</p>
<p> <b>Reputation</b></p> <p><i>Positive perceptions by stakeholders typically lead to less cost and greater flexibility resulting in enhanced enterprise value</i></p> <p>ERCOT's Reputation is below desired levels primarily due to fallout from 2004 scandal. Increased scrutiny resulting from the Fee Case filing, high visibility of Nodal implementation, and the potential for renewed focus. Dec '05 Retail Transaction systems issues have increased Market Participant scrutiny.</p>	<p> <b>Human Resources</b></p> <p><i>Organization design, managerial and technical skills, bench strength and reward systems are aligned with corporate goals</i></p> <p>Compensation program design, poor career path definition, NODAL staffing contribute to the risk of not attracting and retaining quality employees. Staff turnover levels present a risk issue. Compensation redesign, incentive bonuses, tuition reimbursement, and succession planning are ongoing mitigation activities.</p>	<p> <b>Counterparty Credit</b></p> <p><i>Bankruptcies and other capital deficiencies increase the cost for market participants and potentially impact Grid reliability through participant failure</i></p> <p>Processes for removing defaulting participants from the market increases the potential for credit losses. A medium to large market participant default could materially impact the ERCOT market, grid reliability, and ERCOT's reputation.</p>	<p> <b>Bulk System Resources</b></p> <p><i>Market Participants have constructed and made available adequate bulk electric grid resources</i></p> <p>Uncertainty surrounding generation projects, installed and operational capacity, and the high dependency on natural gas in Texas' generation fleet may impact reliability.</p>	<p> <b>Communication</b> </p> <p><i>Internal and external communications are timely and effective</i></p> <p>Internal and external communications are below desired standards with improvement needed in both methods and message. Lack of sufficient internal communications was cited as a primary employee concern with respect to job satisfaction.</p>	<p> <b>Industry Standards</b></p> <p><i>Business practices provide stakeholders with required assurances of quality</i></p> <p>Failure to adhere to ERCOT adopted industry standards, and/or industry standards with which ERCOT is expected to adopt, may increase risks. Changes in NERC / FERC standards and policies require ERCOT action to ensure ongoing compliance. SAS 70 Audit Issues remain to be addressed.</p>
<p> <b>Fiscal Management</b></p> <p><i>ISO design requires competent, prudent and cost effective provision of services</i></p> <p>Current fiscal practices are effective in managing and controlling costs. Management has a focus on cost control having developed a key corporate goal to monitor on-going cost savings.</p>	<p> <b>Technology Infrastructure</b></p> <p><i>Information systems and data are effectively managed and are reliable</i></p> <p>System development, testing, implementation, and data management environments are not at desired levels. The technology roadmap is not clearly defined and contributes to overall technology inefficiencies. Dec '05 Retail Transaction systems issues evidence of existing infrastructure concerns.</p>	<p> <b>Settlement &amp; Billing</b></p> <p><i>Accounting is timely and accurately reflects electricity production and delivery on behalf of buyers and sellers</i></p> <p>ERCOT's settlement/dispute processes has a small number of ADR's outstanding, however these are being addressed in a timely fashion. The recent SAS 70 audit has found no significant issues in the 13 Settlement &amp; Billing control areas.</p>	<p> <b>Operational Responsibility</b></p> <p><i>Market participants conduct their operations in a manner which facilitates consistent grid reliability</i></p> <p>Ineffective ERCOT enforcement ability relating to reliability standards may lead to gradual erosion of reliability.</p>	<p> <b>Adequacy and Integrity</b></p> <p><i>Robust processes exist to support management assertions embodied within financial reports</i></p> <p>Financial and Operations management information is being redesigned to enable management to effectively monitor and manage all aspects of the business. No significant items identified at this time. A fully functioning Compliance and Disclosure risk sub committee will further support this area.</p>	<p> <b>Regulatory Filings</b></p> <p><i>Evidence, testimony and other supporting materials are compelling and successful</i></p> <p>Failure to properly review and timely file required information may result in incomplete, inaccurate, or late filings. Competing priorities may impact the accuracy and timeliness of filings.</p>

Legend: Elevated Risk Level Reduced Risk Level (New Risk Categories Indicated in Green)

**Rationale for Category Risk Assessment Changes**

Performance Monitoring  
Customer Choice  
Review Practices  
Communications

Upgrade  
Downgrade  
Upgrade  
Upgrade

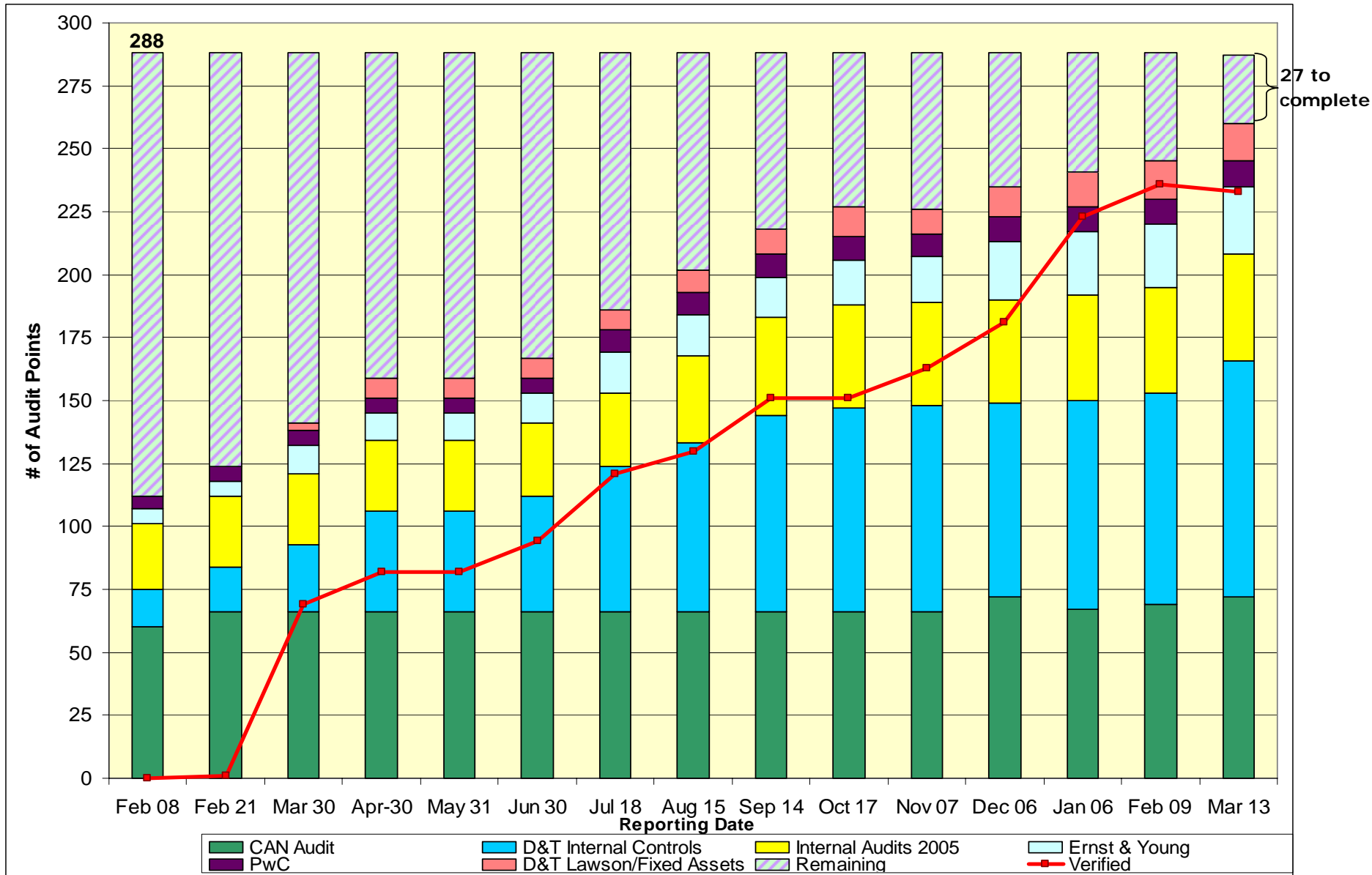
Implementation of new performance measurement tools and dashboard reports reduces risk inadequate performance monitoring  
New Category with initial risk assessment of "Yellow"  
Changes in review practices and Board of Director involvement in process result in decreased risk of non-accurate information  
Changes in communications policies and review of current practices and initiation of disclosure committee reduce risk

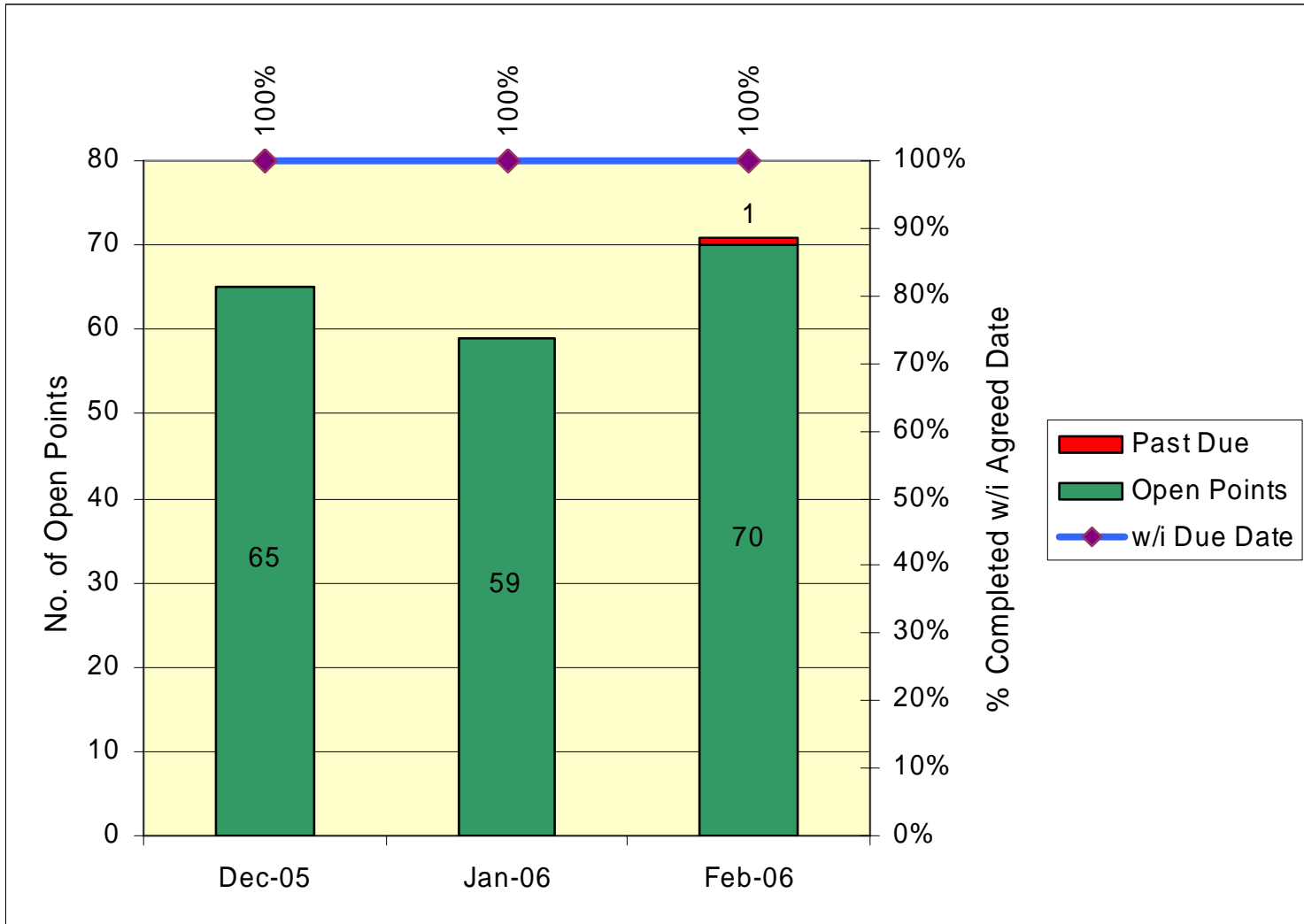
71

Audits Completed	<u>Open Audits</u>	Planned Audits
(last 3 months)		(next 3 months)
<u>Internal Audits</u>	<u>Internal Audits</u>	<u>Internal Audits</u>
<ul style="list-style-type: none"> <li>❑ Cyber Security</li> <li>❑ EMMS</li> </ul>	<ul style="list-style-type: none"> <li>❑ Congestion Management/ TCR</li> <li>❑ Market Operations</li> <li>❑ PRE SAS70 Consultation (Physical Security)</li> <li>❑ Lawson HR System</li> <li>❑ General Ledger Entries</li> <li>❑ MV-90</li> <li>❑ Fraud Prevention (ongoing)</li> </ul>	<ul style="list-style-type: none"> <li>❑ Payroll</li> <li>❑ Credit</li> </ul>
<u>External Audits</u>	<u>External Audits</u>	<u>External Audits</u>
<ul style="list-style-type: none"> <li>❑ 2004 Benefits Audit (PwC)</li> <li>❑ 2005 SAS70 (PwC)</li> </ul>	<ul style="list-style-type: none"> <li>❑ 2005 Financial Audit (PwC)</li> </ul>	<ul style="list-style-type: none"> <li>❑ 2006 SAS70 (PwC)</li> <li>❑ Review of Internal Controls</li> </ul>

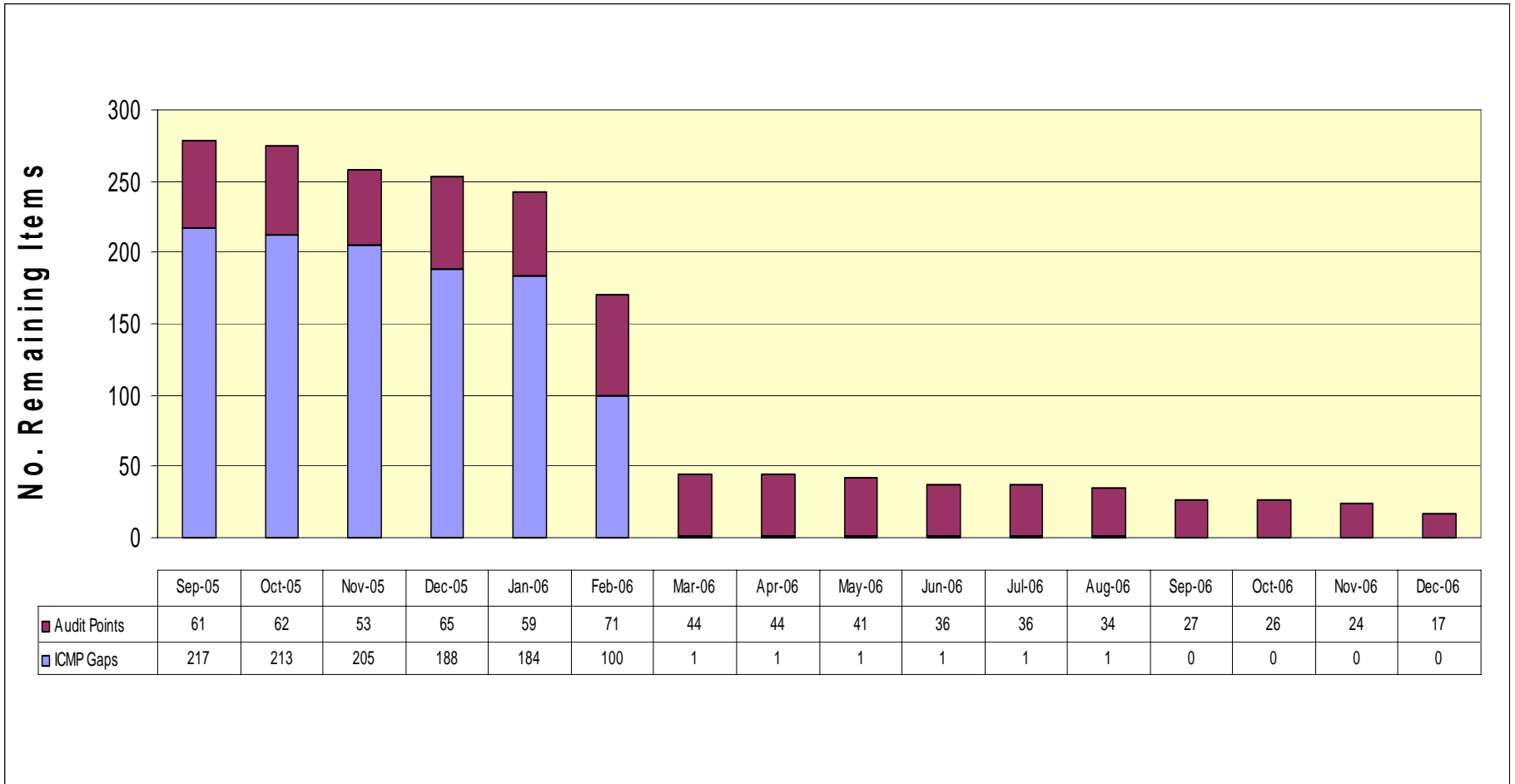


- Approval of documents to remediate documentation gaps for business processes will be substantially complete by 3/31
- Additional resources engaged to assist with gap remediation, review/evaluate controls and QA/QC of control design
- Control activities under review to update control documentation, including remediation of controls based on control self assessments and internal audit testing conducted
  - Control Activities will be updated in control repository by 4/15/06
- Training updates for business processes are being conducted in late Q1 & early Q2









- Update on 2005 Financial Audit
- Review Finance & Audit Self Assessment Results
- Review Status of ICMP and Internal Control Audit Preparedness
- Executive Session
  - Review significant audit findings
  - EthicsPoint
  - Review Status of Annual Audit Plan

## Quarter 1

- *Elect officers and confirm financial qualifications*
- *Review Finance Audit Committee charter*
- Approve the Guidelines for Engagements of External auditors for Other Services (pre-approval policy)
- Review and approve ERCOT Annual Report
- Required written communication and discussion of auditor independence
- *Review scope of annual financial audit*
- **Review EthicsPoint activity**
- **Approve minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review of significant audit findings and status relative to annual audit plan**

## Quarter 3

- Appoint the independent auditors for upcoming year
- Approval of independent auditor fees for upcoming year
- Assessment of internal control environment and systems of internal controls
- Review and approval of annual operating budget
- **Approve minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review EthicsPoint activity**
- **Review significant audit findings and status relative to annual audit plan**

## Quarter 2

- Report results of annual independent audit to the board
- Report of external auditor pre-approval status/limits
- Review the procedures for handling reporting violations
- Review conflict of interest and ethics policies
- Review results of annual audit (including required communications)
- **Approve minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review EthicsPoint activity**
- **Review significant audit findings and status relative to annual audit plan**

## Quarter 4

- Approve audit committee meeting planner for the upcoming year, confirm mutual expectations with management and the auditors
- Review and approval of Financial, Investment & Credit policies
- Approve scope of internal auditing plan for upcoming year
- Assessment of the adequacy and effectiveness of the Internal Audit staff
- Perform Finance & Audit committee Self Assessment
- **Review minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review EthicsPoint activity**
- **Review significant audit findings and status relative to annual audit plan**