



# MEMO

**Date:** March 14, 2006  
**To:** ERCOT Board of Directors  
**From:** Steve Byone & Ron Hinsley  
**Subject:** Nodal Cost Recovery Surcharge Filing

## Issue for the ERCOT Board of Directors

**ERCOT Board of Director Meeting Date:** March 21, 2006

**Agenda Item No.:** 9a

### **Issue:**

The Public Utility Commission has instructed ERCOT to modify its existing wholesale market structure to implement a nodal design in place of the existing zonal market design. ERCOT must be able to recover the costs of this “Nodal project” and, to do so, will make a filing with the Public Utility Commission (PUC) for approval of a surcharge to its approved System Administration fee. ERCOT Staff has developed several different Nodal project financing options for consideration by the Finance and Audit Committee. Board approval is requested for ERCOT to make the PUC filing, consistent with the recommendations of the Finance and Audit Committee.

### **Background/History:**

By letter dated November 22, 2005 ERCOT notified the PUC of its intention, subject to PUC approval, to utilize \$5.1 million in unspent funds from the 2005 budget to support the initial costs associated with the Nodal project. The PUC approved ERCOT’s request at its December Open Meeting. Approximately \$528,000 of that amount had been spent by the end of February 2006 and commitments will be required in the very near future for much of the remainder. Now that the Nodal Protocols have been approved, ERCOT’s business requirements work on the project will begin in earnest so ERCOT needs a source of funds to pay for the Nodal project costs it will incur. It plans to do so by requesting PUC approval of a surcharge over and above its current System Administration fee. Board approval is needed for ERCOT to make this regulatory filing and for ERCOT to borrow funds, as needed, to finance Nodal costs, over and above the \$5.1 million amount, until PUC approval for a surcharge mechanism is given.

### **Key Factors Influencing Issue:**

There are several key factors that must be considered in determining how to fund the Nodal Project.

- 1) Impact on ERCOT’s financial position. Higher debt levels can negatively impact ERCOT’s balance sheet. Higher levels of revenue funding via the Nodal Surcharge strengthen ERCOT’s balance sheet.



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- 2) Overall cost of the project. The more debt incurred, the more interest cost must be paid and thus the higher the overall cost of the project.
- 3) Matching of the payment for the Nodal Project via the Nodal Surcharge with the benefit from the Nodal Project once it is in place.
- 4) Desire to minimize “spiking” in the Nodal Surcharge. The need or desire to have a consistent, predictable fee that will not fluctuate significantly.

### **Alternatives:**

ERCOT Staff prepared and the Finance and Audit Committee of the BOD reviewed the following five scenarios for funding the Nodal Market Restructuring project (Nodal Project). The scenarios are intended to encompass the range of options available for funding the Nodal Project.

In all scenarios the full cost of the Nodal Project will be recovered no later than the end of the average useful life of the assets developed, which is currently assumed to be four years.

- 1) Flat fee – This option anticipates funding the Nodal Project using a blend of borrowed funds and a Nodal Surcharge to produce a relatively flat fee over the period from 2006 – 2012 (both the development period and the estimated average useful life of the assets).
  - a. Fee = approximately 6.6 cents for seven years
  - b. Funding during development = approx 38%
- 2) 100% Revenue funding during development – This option anticipates funding all Nodal Project costs during development (from 2006 – 2008)
  - a. Fee = approx 15.3 cents for three years
- 3) 50% Revenue funding during development – This option anticipates funding half of the Nodal Project during development and half over the estimated average useful life of the assets.
  - a. Fee = approx 8.3 cents during development, approx 5.3 cents over estimated average useful life of the assets
- 4) 10% Revenue funding during development – This option anticipates funding ten percent of the Nodal Project cost during development with the balance over the estimated average useful life of the assets.
  - a. Fee = approx 2.7 cents during development, approx 9.6 cents over estimated



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average useful life of the assets

- 5) 100% Debt funding during development – This option anticipates funding all costs of development with debt with repayment from 2009 – 2012.
  - a. Fee = interest only during development (to be covered from operating funds) and approx 11.6 cents over the estimated average useful life of the assets

These scenarios and the relative benefits of each are discussed further in the attached summary.

**Conclusion/Recommendation:**

The Finance & Audit Committee will make a recommendation to the Board on this issue following the March 21, 2006 Finance and Audit Committee meeting.



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## **ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.** **BOARD OF DIRECTORS RESOLUTION**

WHEREAS, the Board of Directors (“the Board”) of the Electric Reliability Council of Texas, Inc. (“ERCOT”), a non-profit corporation (“Company”), deems it desirable and in the best interest of the Company for a source of financing to be provided to cover the costs ERCOT will incur related to the implementation of the Nodal market redesign project (“Nodal project”), and

WHEREAS, ERCOT is required to request approval by the Public Utility Commission of Texas (“PUC”) for ERCOT to collect a fee in the form of a surcharge to its System Administration fee (or some other comparable mechanism) to pay for Nodal costs ERCOT incurs, and

WHEREAS, until the PUC approves a surcharge or another comparable mechanism to finance ERCOT’s costs associated with the Nodal project, ERCOT will be required to borrow money to provide a source of revenue.

NOW THEREFORE, BE IT RESOLVED, that ERCOT is hereby authorized to make a filing at the PUC requesting authority to impose a surcharge or some other comparable mechanism to recover costs ERCOT incurs in connection with the Nodal market redesign project, and

RESOLVED FURTHER, that ERCOT is hereby authorized to borrow funds, as necessary, to finance Nodal project costs until a cost recovery mechanism is approved by the PUC.