Date: February 13, 2007
To: ERCOT Board of Directors
From: Clifton Karnei, Chairman of the Finance and Audit Committee
Subject: Application of the Expected 2006 Actual vs. Budget Revenue Requirement Variance

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: February 20, 2007
Agenda Item No.: 7c

Issue:
At the February 20, 2007 meeting of the ERCOT Finance and Audit Committee, Committee members reviewed estimates of the expected 2006 Actual vs. Budget variance and considered alternatives for the use of the funds made available by the favorable budget variance. At this time, the Finance and Audit Committee recommends the following action to the Board:

The Finance and Audit Committee recommends that the Board direct ERCOT staff to apply any favorable budget variances from the 2006 budget year to reduce debt-funding of 2007 projects.

Background/History:
ERCOT staff presented financial forecasts of its results of operations for fiscal 2006 to the Finance & Audit Committee and Board of Directors at various times throughout 2006. Each time, ERCOT indicated that a favorable budget variance was expected.

Based on preliminary financial information, ERCOT expects that it will likely have recorded income totaling approximately $7.3 million in excess of revenue requirements for the year. The projected favorable budget variance is primarily the result of favorable energy consumption (leading to higher-than-budgeted System Administration Fee revenue), interest income, and non-operating income relating to insurance recoveries.

The Committee considered several options regarding how to address the utilization of ERCOT's projected favorable financial variance, including (1) reducing the ERCOT System Administration Fee, (2) refunding of a portion of ERCOT System Administration Fee proceeds, (3) increasing 2007 project funding, and (4) reducing ERCOT debt or reducing the debt-funded portion of 2007 capital project expenditures. The first two options would require approval of the Public Utility Commission.

After final discussion at the February 2007 Committee meeting, the Committee arrived upon the recommendation described above.

Key Factors Influencing Issue:
In approving ERCOT's 2007 budget the Board of Directors resolution included authorization

for a temporary debt funding ratio of 27 percent revenue and 73 percent debt in 2007 but required ERCOT management to reinstate the standard ratio of 40 percent revenue and 60 percent debt by December 31, 2008.

During the discussion and deliberation leading to the approval of ERCOT's 2007 budget, PUCT Commissioner Smitherman stated that he recommended the PUCT consider entering an order requiring that ERCOT restore the Debt/Revenue ratio of 60/40 by December 31, 2008.

Alternatives:

1. Approve the recommendation of the Finance and Audit Committee, as recommended or as modified by the Board;
2. reject the recommendation of the Finance and Audit Committee;
3. remand this issue to the Committee with instructions; or
4. defer action until a later Board meeting.

Conclusion/Recommendation:

The Finance and Audit Committee recommends that the Board approve Alternative "1" as described above.

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

WHEREAS, the Board of Directors ("Board") of Electric Reliability Council of Texas, Inc. ("ERCOT") deems it desirable and in the best interest of ERCOT to formalize its direction to ERCOT management with regard to favorable financial variance realized from its operations in 2006.

THEREFORE, be it RESOLVED that ERCOT is hereby directed to apply any favorable budget variances from the 2006 budget year to reduce outstanding debt or reduce debt-funding of 2007 projects.