

## ERCOT

### Finance & Audit Committee Meeting

**7620 Metro Center Drive, Room 206, Austin, Texas**

**March 21, 2007 8:30 a.m. – 10:00 a.m.\*\***

<b>Agenda Item #</b>	<b>Description/Purpose/Action Required</b>	<b>Presenter</b>	<b>Time</b>
	Call to order	M Espinoza	8:30 a.m.
1.	Adjourn to Executive Session		
	• Internal audit status report	B Wullenjohn	8:30 a.m.
	• EthicsPoint update	S. Maslon	8:40 a.m.
	• Discussion of MAPS validation by internal audit	B Wullenjohn/ M Petterson	8:45 a.m.
	Reconvene to General Session		8:55 a.m.
2.	Approval of minutes • F&A 20070220 (Vote) • CWG Workshop 20070305 (Vote)	M Espinoza	8:55 a.m.
3.	Review proposed Finance & Audit Committee Charter changes (Vote)	S Vincent	9:00 a.m.
4.	Review proposed Credit Work Group Charter changes (Vote)	C Yager	9:15 a.m.
5.	Update on liquidity/liability management	C Yager	9:30 a.m.
6.	Financial audit update	M Petterson	9:35 a.m.
7.	Preliminary 2008 planning assumptions	M Petterson	9:40 a.m.
8.	Committee briefs (Q & A only)	All	9:45 a.m.
9.	Future agenda items	M Petterson	9:55 a.m.
	Adjourn		10:00 a.m.

*\*\* Background material is enclosed or will be distributed prior to meeting. All times shown in the agenda are approximate.  
The next F & A Committee Meeting will be held April 18, 2007 at Hilton Austin Airport Hotel, 9515 Hotel Drive, Austin, Texas 78719, in the Wildflower Room.*

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

Austin Met Center

7:30 A.M.

**February 20, 2007**

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 7:30 A.M. on **February 20, 2007**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

**Meeting Attendance**

**Committee members:**

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Present
Miguel Espinosa, Vice Chair	Independent Board Member	Independent Board Member	Present
Nick Fehrenbach	City of Dallas	Consumer	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present
William Taylor	Calpine Corporation	Ind. Generator	Present
Dan Wilkerson	Bryan Texas Utilities	Municipal	Present

**ERCOT staff and guests present:**

Anderson, Troy	ERCOT
Barry, Sean	PricewaterhouseCoopers (PwC) via telephone
Byone, Steve	ERCOT (CFO)
Brenton, Jim	ERCOT
Campbell, Cassandra	ERCOT
Day, Betty	ERCOT
Giuliani, Ray	ERCOT
Jones, Sam	ERCOT (CEO)
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Petterson, Mike	ERCOT
Thomas, Bob	Green Mountain
Vincent, Susan	ERCOT
Yager, Cheryl	ERCOT
Westbrook, Susan	ERCOT

**Executive Session**

At 7:30 AM, the Committee meeting was adjourned and the Committee went into Executive Session until approximately 8:30 AM. The Committee returned to Open Session at 8:36 AM.

**Approval of Previous Minutes**

**Nick Fehrenbach moved to approve the minutes for the previous meeting held on January 15, 2006; William Taylor seconded the motion. The motion passed unanimously.**

## **Review Finance and Audit Committee charter**

Steve Byone highlighted the proposed changes to the Committee Charter and asked for input and additional modification suggestions from the Committee. The members discussed whether they should add a requirement to have at least two Unaffiliated Directors on the Committee and agreed to discuss this proposal with the Board Chair. Mr. Karnei requested that the Charter specifically state that Segment Alternates could attend the executive sessions of the Committee. The Committee agreed that they would vote to recommend proposed changes to the Charter to the Board at the March meeting.

## **Lessons Learned from 2006 SAS 70**

Sean Barry and Jim Brenton discussed the lessons learned from the 2006 SAS 70 audit. Mr. Brenton told the Committee that ERCOT staff was working closely with PwC to ensure there is agreement on control objectives for the 2007 SAS 70 audit. Mr. Brenton informed the Committee that Internal Audit was conducting a pre-audit to prepare for the beginning of the 2007 SAS 70 and that management had completed all short-term (pre January 1, 2007) remediation activities identified after the 2006 audit and that long-term remediation was on schedule. Mr. Brenton assured the Committee that the SAS 70 remediation was his group's highest priority. Mr. Barry informed the Committee that PwC had just issued its Management Recommendation, and he reviewed with the Committee the three PwC recommendations: (1) Develop a strategy for continuous review of business processes and related controls; (2) Complete and validate enhancements of processes related to logical security (); (3) Refine the SAS 70 reporting process to maximize its benefits to users (ensure that only key controls were listed to reduce burden of non-key items). Mr. Barry noted that, with regard to Item (2), PwC had not audited the items that management stated it would do in December, so the recommendations were based upon PwC's understanding of the actions that had been taken.

William Taylor noted that the lessons learned appeared to be typical items coming from any SAS 70 and asked if any of the items were actually more significant. Mr. Barry stated that although most of the results were quite typical, the last item (obtaining agreement with ERCOT on the key control activities) was the "meat and potatoes" of the list and needed to be accomplished.

Mr. Karnei asked if management had any comments about the report or management recommendations. Ray Giuliani noted that the results from the last two years demonstrated that management was engaged in ensuring the control activities. Mr. Karnei asked if management was on board with the PwC recommendations, and Mr. Brenton confirmed that management had worked with PwC on and concurred with the recommendations. Mr. Brenton stated that the SAS 70 audit results had identified that ERCOT was not yet at the required maturity level, but that his Security team had redoubled its efforts to refine processes. Mr. Brenton stated that he felt that ERCOT was much more mature than in previous years, and that the processes were now more repeatable and documented. Miguel Espinosa asked if Mr. Brenton was comfortable that the same items would not be an issue in the 2007 audit, and Mr. Brenton confirmed that ERCOT's goal was to be "clean" in the future audits.

Mr. Karnei reiterated that the Committee would like to have a clear audit for 2007. Scott Gahn confirmed with Sean Barry that ERCOT's SAS 70 did not include any of its retail systems.

## **Review of 2006 Financial Results and Use of Surplus Funds**

Mike Petterson reminded the Committee that, relative to expected revenue requirements, ERCOT ended 2006 with a favorable financial variance of approximately \$7 million. Mr.

Petterson explained that, consistent with past practice and in an effort to keep the Board of Directors informed regarding significant elements of ERCOT's financial performance, management wanted to formalize the Board's direction regarding the use of the revenue variance. Because of the desire to maintain revenue funding of 40%, Mr. Petterson stated that management recommended and sought formal approval from the Board to use the favorable financial variance to reduce debt-funding of projects in 2007.

If approved, the favorable variance from 2006 applied to 2007 budgeted project spending would enable ERCOT to exceed the targeted 40 percent revenue funding and have revenue funding of 44%. Scott Gahn questioned whether the Committee should recommend using the revenue to increase debt funding to 40% and use the remainder for projects, and Mr. Byone confirmed that this was another option. The Committee discussed its options.

**Miguel Espinosa made a motion to recommend that ERCOT be hereby directed to apply any favorable budget variances from the 2006 budget year to reduce outstanding debt or reduce debt-funding of 2007 projects. Dan Wilkerson seconded the motion. The motion passed unanimously.**

Mr. Wilkerson requested that, for any future requests, the resulting debt percentages be included in the Board template.

#### **Approval of Auditors for Benefit Plans**

Mr. Petterson reminded the Committee that ERCOT's Money Purchase Plan (MPP) was terminated in March 2006, when the assets were rolled into ERCOT's 401(k) Savings Plan. Mr. Petterson explained that the final audit of the MPP was required to be completed within 6 months of termination, but the deadline had been missed. Mr. Petterson told the Committee that, because penalties and fines were possible, management wanted to complete the final MPP audit as quickly as possible. Although PwC was committed to completing the MPP audit for ERCOT, for a variety of reasons including staff availability, staff expertise, and cost, PwC had suggested that ERCOT select a different auditor for the final MPP audit, and ERCOT had obtained competitive bids for the final MPP audit and for the audits of the 401(k) Savings Plan for 2006, 2007, and 2008. Mr. Petterson informed the Committee that staff recommended that Maxwell, Locke & Ritter, one of the firms suggested by PwC, be approved as the auditor for the final MPP audit and, because of the cost efficiencies of auditing multiple years, for the 2006-2008 401(k) Savings Plan audits.

**Miguel Espinosa made a motion to recommend that the board approve Maxwell Locke and Ritter as Auditor of the employee benefit plans for a period of 2006 through 2008; Tom Standish seconded the motion. The motion passed unanimously.**

#### **Assessment of Compliance, the Internal Control Environment and Systems of Internal Controls**

Cheryl Moseley overviewed the compliance and Internal Control Management Program (ICMP) for the Committee. Mr. Byone reminded the Committee that Deloitte & Touche would give a presentation to the full Board about the recently complete internal controls review. Ms. Moseley reminded the Committee that ERCOT management had established a strong tone at the top in support of internal controls and that control self-assessment were conducted periodically. Ms. Mosley explained that audit reports and control self-assessment results were reviewed to ensure the control environment was functioning as intended, and that ERCOT was performing ongoing monitoring and updating of controls based on business risk. Mr. Karnei asked Ms. Moseley to confirm that the audit point repository did not yet contain the controls that were

audited during the SAS 70 audit, and he asked if the SAS 70 controls could be added to the program of self assessments. Ms. Moseley informed the Committee that it was ERCOT's goal to add the SAS 70 control activities to the control repository, and she expected that this would be accomplished by the end of 2007. Mr. Espinosa asked if ERCOT was comfortable that policies and procedures were being reviewed by all personnel. Mr. Byone told the Committee that an ethics update was performed each year, where all employees were required to re-sign an Ethics Agreement, and that training on specific policies and procedures was conducted over the course of the year.

### **Briefing on nodal surcharge filing**

Mr. Byone informed the Committee that, notwithstanding the ice storm and other setbacks, the nodal surcharge filing was made timely, requesting a \$0.127 flat fee be implemented by June 1, 2007. Mr. Byone noted that the filing requested an expedited process for fee changes, in the event unanticipated issues arose, and a true-up after go-live. Mr. Byone noted that ERCOT staff provided a pricing grid in the filing, to demonstrate the impact of any delays in implementation, and that ERCOT requested a higher level of fee if implementation was delayed beyond June 1, 2007. Mr. Byone further explained that the filing stated that ERCOT staff would not support a flat fee if implementation was delayed beyond September 2007, because after that point, the revenue contribution during development would then be expected to fall below 30%. Mr. Karnei and Mr. Espinosa requested copies of the filing so that they could review. Tom Standish asked and Mr. Byone confirmed that the payment completion date would remain constant regardless of the rate. Dan Wilkerson requested that the filing be shared with the full Board. Mr. Karnei requested that the chart showing the summary of incremental Nodal fees associated with various effective dates be used at the Board meeting.

### **Liquidity Update**

Cheryl Yager reviewed the current status of outstanding debt and available debt capacity and reminded the Committee that the bulk of the Nodal spend was expected to occur during 2007 and 2008. Ms. Yager noted that, with the currently projected Nodal and base operation spending, ERCOT projected a need for additional liquidity at mid-year 2007. Ms. Yager explained that staff expected to need to increase debt capacity (not including the term note or senior notes) by \$110 million through 2008, which would be in addition to the current revolver note. Tom Standish asked if the cash needs would continue through 2008, and Ms. Yager stated that there would be no steady state for cash until 2009. In response to Committee questions, Mr. Byone confirmed that staff did not project any reduction in nodal debt until 2009. Ms. Yager told the Committee that ERCOT will bring the Committee a proposed financing plan to meet near term and two year liquidity needs no later than April 2007. Mr. Standish, Mr. Wilkerson and Mr. Karnei noted that it would be helpful to have a timeline of expected spend when the Committee looked at this issue in April.

Ms. Yager explained that staff would likely seek additional liquidity while the Nodal Surcharge filing was still in process. Therefore, ERCOT will seek to be flexible in defining how debt will be repaid. Ms. Yager highlighted other key requirements of the financing options, and noted that, ERCOT would consider including other lenders for bank debt or doing a private placement offering (which would be less flexible) to ensure ERCOT maintains capacity in the various markets to issue debt, if needed, in the future. Ms. Yager also noted that, because of the Financial Standard requirement to keep variable rate debt under 40% of total debt outstanding, ERCOT may seek to do another interest rate swap. The Committee recommended and Ms. Yager confirmed that staff would get a fairness opinion for any interest rate swap. Mr. Byone

reviewed the current rate environment and noted that it was a favorable. He also noted that, in response to a request by a Board member, ERCOT had looked at securitization, but that this was not currently expected to yield a lower rate in the bank market given ERCOT's current credit rating, but that ERCOT would continue to evaluate potential benefit for purposes of a private placement. The Committee discussed the issues relating to the various debt options.

### **Capital Project Update**

Troy Anderson explained that the de-centralization of the Project Management Organization (PMO) contributed to the successful project completions of 2006 and provided an overview of the governance hierarchy of the PMO. Mr. Anderson noted that 63 projects were delivered in 2006, for the amount of \$36.154 million, with 91% on budget and 71% on time. He informed the Committee that the 2007 project forecast included 66 projects for \$30 million, plus the \$14 million for the Nodal critical path projects. Mr. Anderson noted that three projects were going before the Board to begin execution (so further details would be provided in Executive Session):

PR-40038\_01 TX SET 3.0, Mass Transition, PR-60099\_01 TCC2 Finish-out and Annex Construction, and PR-60020\_01 Lawson Managed Application Service Provider. Mr. Anderson explained that the TX SET 3.0 project was set to be completed by June 2007 and, because of efficiencies experienced by combining several projects, had a reduction in budget of approximately \$2 million over its original PPL placeholder amount. Mr. Anderson discussed significant 2007 initiatives, as described in the Committee materials including providing an impact analysis on all proposed projects, periodic post project reviews, and a cost benefit analysis review team. William Taylor asked how PMO would demonstrate the new efficiencies and requested that the Committee be provided with concrete examples in addition to bullet point lists.

### **Committee Briefs**

Mr. Karnei asked if any members had questions about the ERM materials. Mr. Espinosa asked if there were any significant changes in risk. Mr. Byone noted that several items had decreased in risk, and Mr. Karnei noted that Nodal was still red.

### **Future Agenda Items**

Mr. Byone reviewed the list of future agenda items and asked if the members were interested in adding other topics. No additional topics were requested, but Mr. Karnei noted that he would be gone in March, so Mr. Espinosa would chair the meeting.

### **Adjournment**

At 9:54 A.M., the meeting was adjourned. The next Committee meeting will be held on the morning of March 20, 2007.

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Susan Vincent, Secretary

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

Credit Workshop  
Austin Met Center  
March 5, 2007

**Meeting Attendance:**

Board Members

William Taylor - Calpine  
Scott Gahn – Just Energy  
Clifton Karnei – Brazos Electric Coop  
Miguel Espinosa - Unaffiliated  
Bob Thomas – Green Mountain Energy  
Dan Wilkerson – Bryan Texas Utilities  
Nick Fehrenbach – City of Dallas  
Brad Cox – Tenaska Power Services (by phone)

Other Guests

Barry Smitherman – PUCT Commissioner  
Morgan Davies – Calpine, Chair of Credit Working Group (CWG)  
Keith Emery – Tenaska  
Robert Miller – CPS Energy  
Bruce Thompson – Airtricity  
Robert Alsbrooks – Tenaska  
Tamila Nikazm – Austin Energy  
Marguerite Wagner – Reliant  
Neal Frederick – PUCT Staff  
Darryl Tietzen – PUCT Staff

ERCOT Staff

Steve Byone  
Cheryl Yager  
Andrew Gallo  
Susan Vincent  
Chad Seely  
Vanessa Spells  
Sriini Sundhararajan  
Don Meek

Pursuant to notice duly given, the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened a Credit Workshop at 1:00 PM on March 5, 2007. Clifton Karnei, Chairman of the Board's Finance & Audit (F&A) Committee, invited Cheryl Yager to begin the meeting by reviewing the agenda. Ms. Yager began with the antitrust admonition.

**Credit Exposure and Credit Risk Factors**

Ms. Yager noted that credit events have occurred over the last several years (~ \$15 million in short-pays and uplifts from 2003 and ~ \$6 million from 2005-2006). She then discussed actions taken by ERCOT Staff and Market Participants to address outstanding credit issues. Ms. Yager stated that, as ERCOT staff understands them, the credit objectives are: (1) to provide financial stability for the market, (2) to ensure Market Participants understand the credit exposure that exists in the market and (3) to assess credit risks as they are identified.

### **Credit Risk Factors**

- Creditworthiness of QSEs representing Load
- Credit exposure

Ms. Yager noted that all credit risk factors should be viewed together as the Board considers the overall credit position of the market.

She then provided statistics regarding QSEs representing Load, including that 76% of QSEs do not meet the creditworthiness standards established by the ERCOT Board. Commissioner Smitherman asked for the creditworthiness standards and Ms. Yager provided a brief summary of those standards.

Ms. Yager indicated that, when considering the credit quality of the market as a whole, the Board should consider the effect of recent changes in the market place that might affect credit quality over the near term, including removal of the price to beat and an increase in the offer cap. She also indicated that the Board should consider trends to date in the overall credit quality of the Market Participants, noting that, overall, QSEs representing Load are generally weaker financially than the group as a whole five years ago.

Mr. Karnei pointed out that only eight of seventy QSEs directly meet the creditworthiness standards.

Commissioner Smitherman asked about the split between Market Participants that post cash versus Letters of Credit. Ms. Yager stated that she did not have that information with her, but noted that ERCOT's experience has been that both cash and Letters of Credit are fairly easily accessed in the event of a default.

In discussing past defaults, Mr. Gahn mentioned that many of the market rules have changed since the 2003-2005 timeframe. Ms. Yager agreed that had the same events occurred today, the defaults would likely have resulted in less loss to the market.

However, Ms. Yager pointed out that, even after the changes to the market rules, significant exposure can occur before ERCOT can identify the problem (e.g. from unexpected market shocks -- curtailments, weather events, etc. -- or from individual Market Participant behavior). Additionally, Balancing Energy Service (BES) prices are significantly impacted by the amount of MWhs taken from BES and can fluctuate dramatically and unexpectedly.

Ms. Yager raised the question of whether the market rules and credit mitigation strategies should address only "normal" credit issues or whether they should prepare for "shock" events.

Ms. Yager then presented an example of a Market Participant default for a relatively large entity, yielding a short pay and uplift of ~ \$78 million.

Mr. Taylor pointed out that the example assumes a large number of Market Participants defaulting at the same time or a very large Market Participant default. Ms. Yager agreed, but pointed out that this slide was intended to show the impact of a big event, not necessarily its probability.

Additionally, Ms. Yager pointed out that ERCOT calculates collateral based on historical usage which, in most Mass Transition situations, will not cover all of the future exposure. ERCOT also cannot limit MWh use of BES; i.e. if a QSE loses a bi-lateral contract, its Load is served entirely through BES and ERCOT cannot shut off the flow of electricity in the near term.

Ms. Yager then presented a slide demonstrating the improvement of the market rules to address Mass Transition situations over the last few years, pointing out, however, that a “gap” in credit still exists (albeit a smaller gap than in the past).

Ms. Yager then discussed differences between how the various Independent System Operators address defaulting entities and provided an example of a short-pay and uplift event.

### **Legal/Policy Directives Re: Financial Stability in the ERCOT Region**

Andrew Gallo then addressed Legal and Policy considerations associated with credit issues.

Mr. Karnei pointed out that the PUCT rules (§25.503) contain a reference to credit issues and indicate that the PUC has delegated this responsibility to ERCOT. Mr. Gallo agreed, but questioned whether the reference to “ERCOT” in that rule means “ERCOT Staff” or “ERCOT Market Participants.” Mr. Karnei opined that these provisions mean ERCOT, Inc.

Mr. Gahn commented that these provisions do not necessarily mean ERCOT, Inc. and raised a question regarding whether the rule means the ERCOT Board, ERCOT Market Participants or ERCOT, Inc.?

Commissioner Smitherman gave an example of the perfect storm in which the governor called the PUCT after a significant credit event and the PUCT indicated that it delegated credit issues to ERCOT and ERCOT Staff would then indicate that they tried to get Market Participants to tighten credit standards, but the Market Participants did not cooperate.

Mr. Gahn commented that it is possible that ERCOT could weaken the market by holding collateral because a company would not be able to use those funds in the bi-lateral market.

Ms. Yager commented that we need to first decide whether, from a credit standpoint, we are where we want to be and if not, what the target is. Then we can discuss how to get there. If further mitigation is needed, the best answer is to take risk out of the market, but other risk mitigation strategies can be considered other than merely increasing collateral requirements. Mr. Gahn commented that he struggles with these issues and whether collateral is the best solution to help protect the market.

Mr. Taylor commented that ultimately it will be the PUC or the Legislature that will force action if there is a situation.

### **Credit Environment**

Morgan Davies, Chairman of the CWG, made a presentation regarding the credit environment in the market.

Mr. Davies highlighted the potentially conflicting goals for the market and individual Market Participants. He then reviewed the processes currently in place to help ensure the financial stability of the market. He pointed out that: (1) ERCOT uses the stakeholder process to address credit issues and (2) the F&A Committee Charter calls for the Committee to review credit topics and ERCOT’s credit policies and make recommendations to the Board regarding those policies. To fulfill this requirement, the Committee relies, in part, on the CWG. He also highlighted changes proposed to the CWG Charter governing the CWG and talked about best practices as defined by the Committee of Chief Risk Officers.

Mr. Espinosa asked whether, in Mr. Davies' opinion, the Technical Advisory Committee (TAC) has sufficiently requested CWG input on credit-related matters. Mr. Davies stated that he believes in many cases, TAC leadership has done so. He also stated that CWG addresses credit issues even when not invited to do so by TAC. Ms. Yager stated that the best credit-related solutions have been developed when TAC or its subcommittees and the CWG work together. Mr. Davies provided an example of how the CWG is working with the Commercial Operations Subcommittee (COPs) on a proposal before COPs to move from daily payment of invoices to weekly payment of invoices in nodal market design.

Mr. Gahn asked about the point in time when the CWG gets involved in the Protocol Revision Request (PRR) process. Ms. Yager stated that CWG provides input to all PRRs as they go to the Protocol Revision Subcommittee (PRS) and will, if asked, provide input earlier in the process. Mr. Gahn asked whether CWG is usually asked to participate early in the process. Ms. Yager indicated that CWG is brought in early in the process some of the time. Sometimes, however, the first time CWG is aware of an issue is when a PRR is moving through PRS.

#### How to Determine an Acceptable Amount of Risk

Ms. Yager then presented information on steps taken in recent years to address credit issues. She mentioned that the F&A committee asked the CWG to address residual credit issues after the PRRs were passed to shorten the Mass Transition timeline. The CWG proposed PRR683 which, ultimately, the PRS rejected. Ms. Yager then reviewed the advantages and disadvantages in the stakeholder process dealing with credit-related issues.

In conclusion, she asked how the Board members and F&A Committee would like to measure/consider credit risk. Did F&A want to: (1) confirm the Market Participants' assessment, (2) seek an independent assessment, (3) compare the current situation to "zero" risk, or (4) do something else?

Mr. Karnei stated that he favors having an independent entity assess the current situation and provide recommendations. Mr. Gahn agreed to that approach, but asked who would conduct such a study. Ms. Yager stated that someone like Standard & Poor's or Moody's could do it, but ERCOT would use a Request For Proposal process.

Mr. Gahn stated that he would prefer that an independent entity provide recommendations and let the Board decide what to do.

He then stated that he has several remaining questions:

- (1) What, if anything, triggers the Board to intervene when Market Participant committees reject further action such as was the case with PRR683?
- (2) What process should the Board use when or if a decision is reached to intervene related to credit issues (is a PRR the only way)?
- (3) How much of this issue is setting credit "policy" and does ERCOT ultimately have the obligation to establish credit "policy" or should the Market Participants request a decision from the PUCT?

Mr. Karnei stated that the F&A Committee reviews credit statistics and topics every month. Additionally, a group of credit professionals (the CWG) made a recommendation (PRR683) and it failed. This indicates that, sometimes, Market Participants may not follow the F&A Committee's recommendations regarding credit issues. Therefore, he suggested that action

may need to be taken directly by the Board. Mr. Taylor expressed concern for any action that may by-pass the stakeholder processes. Ms. Yager noted that the process could begin with a new PRR and, if it fails, it could be appealed to the TAC in the normal course and, if necessary, be appealed to the Board.

Mr. Karnei stated that the Board has a fiduciary duty that the members of PRS do not have. Mr. Taylor stated that, in his opinion, we should cease focusing on PRR683. He believes that credit decisions must have an opportunity to be addressed through the TAC.

Mr. Fehrenbach stated, in his opinion, any changes to the credit policies should go through the stakeholder process. However, if that does not lead to a resolution with which the Board agrees, the Board is not required to follow the stakeholders' recommendation.

Mr. Karnei asked Mr. Byone the earliest date on which an independent assessment could be presented to the Board. Mr. Byone stated that he believes April is the earliest, but we would first need to define the scope of work for the analysis.

Mr. Davies stated that there are two ways to deal with risk: (1) mitigate it (e.g. compressing the Mass Transition timeline) and (2) transfer it (e.g. insurance; derivatives). He stated that derivatives tend to focus on investment grade entities and most ERCOT Market Participants are not investment grade. He also stated that the CWG is looking at ERCOT's credit standards right now.

Mr. Wilkerson stated that there is a perception difference because there are not too many industries in which someone must assess the financial risk he faces of having a *peer* default. Mr. Espinosa pointed out that it was also uncommon for most entities to be able to set the collateral requirements for themselves. Mr. Gahn pointed out that, in the stakeholder process, voting is equally distributed but credit risk is not.

Mr. Fehrenbach stated that the F&A Committee should ensure that ERCOT follows industry best practices regarding risk mitigation. If we are, he believes ERCOT would receive some benefit of the doubt if a "perfect storm" credit event occurred. Mr. Davies stated that the Committee of Chief Risk Officers has a database of "best practices" to which the committee could refer.

Mr. Byone recapped, by stating that he heard consensus among F&A members that the Board has oversight responsibility for financial stability in the ERCOT market. All agreed. He then noted that he heard agreement that the group believed it was appropriate that an independent assessment be undertaken to obtain further information relating to the level of credit exposure remaining in the market and possible alternatives to further address remaining credit risk. The Committee could then use such information to make a determination of next steps, if any.. The Committee concurred on this next step. Therefore, he recommended that ERCOT staff draft an RFP, including input from CWG for specific risk case scenarios, circulate it to F&A Committee members to confirm the scope of work and, ultimately, issue the RFP and present the responses to the F&A Committee for final consideration. The committee agreed with these steps.

Mr. Karnei thanked Commissioner Smitherman for attending and asked for any final thoughts from him. Commissioner Smitherman stated that he appreciated the robust dialogue today and believed the steps outlined would be helpful in the process.

Mr. Karnei then thanked everyone for attending and adjourned the meeting at 3:50 p.m.



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

### Purpose

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

1. Oversee the Company's budget process and adherence to budget;
2. Provide recommendations to the Board of Directors for establishing levels of financing and in setting the Company's fees, including its administrative fee;
3. Review and make recommendations to the Board of Directors regarding credit standards, procedures, governance, ERCOT Protocols and other market rules which impact credit risk, with the goal of maintaining the financial stability of, and minimizing credit loss uplifts to the ERCOT market;
4. Ensure that the Company's financial statements are timely audited by qualified accountants who are independent;
5. Assist the Board of Directors in fulfilling its oversight responsibility with respect to the Company's maintenance of an effective internal audit function;
6. Establish and maintain procedures for the receipt (including anonymous submission), retention and treatment of complaints regarding accounting, internal controls, and auditing;
7. Perform such other duties and responsibilities enumerated in and consistent with this Charter.

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

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

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

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## Membership

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

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

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

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

**Board members (other than Committee members) including Board member alternates may attend and participate in all Committee meetings but may not participate in Committee voting.**

Non-Committee members may attend Committee meetings at the discretion of the Committee. The Committee may exclude any persons who are not Directors, the Segment Alternate or the Director's Designated Representative from any meeting or portion of any Committee meeting that the Committee determines, in its discretion, needs to be held in closed session to discuss personnel issues, confidential legal matters, negotiations or other business of the Committee involving confidential information.

## Qualifications

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

## Authority

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

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

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

### **Structure**

The presence of at least half of the members of the Committee shall constitute a quorum. At any meeting at which a quorum exists, the act of a majority of the members present at a meeting shall be the act of the Committee. For the purposes of voting, members who recuse themselves from voting on an issue shall not be counted as present for that vote.

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

### **Duties and Responsibilities**

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

#### ***With respect to budget oversight and financing:***

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

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*With respect to maintaining the financial stability (? What does "financial stability" mean?, I think we need a credit policy that addresses financial stability and minimizing credit loss uplifts to the market) of the ERCOT market, the Committee shall make recommendations to the Board of Directors regarding:*

1. The adoption and maintenance of a credit standard that defines the goals for the market with respect to financial stability;
2. The adoption and maintenance of credit procedures that provide an appropriate system of checks and balances to help ensure compliance with ERCOT's credit standard, credit procedures, and credit-related Protocols and market rules;
3. The establishment of creditworthiness requirements, methods of evaluating credit exposure and credit risk mitigation strategies which adequately address financial stability goals;
4. Credit implications of all proposed changes to market rules;
5. Other recommended steps for maintaining financial stability of the ERCOT market.

*With respect to the independent auditors:*

1. Annually, the Committee shall recommend to the Board of Directors the selection and engagement 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 (in excess of \$5,000) 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. Provision of non-audit services of less than or equal to \$5,000 by the independent auditor to the Company do not require pre-approval from the Committee, but shall be communicated in writing to the members of the Committee at the first meeting following the engagement for the non-audit services at issue.
4. 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.
5. 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
6. 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.
7. Establish the Company's hiring policies for employees who are former employees of the Company's independent auditors

*With respect to the Company's financial statements:*

1. The Committee shall discuss the annual audited financial statements with management and the independent auditor, including the Company's disclosures.
2. The Committee shall review disclosures made to the Committee by the Company's CEO and CFO about any significant deficiencies in the design or operation of the internal

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- controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.
3. In connection with its review of the Company's financial statements, the Committee shall review and discuss with the independent auditor the matters relating to the conduct of the audit as they may be modified or supplemented, including, but not limited to, significant judgments, significant estimates, critical accounting policies, and unadjusted differences.
  4. Review major changes to the Company's auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.
  5. Review with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or published reports that raise material issues regarding the Company's financial statements or accounting policies.
  6. Review with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.
  7. Review any and all press stories that relate to the Company's accounting and disclosure, require that management or the auditor explain any negative comments and determine whether these comments necessitate a change in the accounting structure of the Company.
  8. Based on its review and discussions with management, the internal auditors and the independent auditor, the Committee shall provide a recommendation to the Board of Directors whether the Company's financial statements should be accepted.

**With respect to periodic reviews and reports:**

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

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**With respect to the other matters:**

1. The Committee shall inquire of management and the independent auditors about significant risks or exposures to the Company and the ERCOT market and assess the steps management has taken to minimize such risks.
2. The Committee shall establish procedures for:
  - a. The receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and

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- b. The confidential, anonymous submission by the Company's employees of concerns regarding accounting or auditing matters.
- 3. The Committee shall review, considering, the recommendations of the independent auditors and the CFO, the scope and plan of the work to be done by the Company's internal auditor, and the results of such work.
- 4. The Committee shall establish the Company's hiring policies for employees who are former employees of the Company's independent auditor's.
- 5. The Committee shall review the appointment and replacement of the senior internal auditing executive, the scope of the internal audit plan and the significant reports to management prepared by the internal auditing department and management's responses.
- 6. The Committee shall meet at least biannually with the independent auditor, the chief financial officer and the senior internal auditing executive in separate executive sessions.

### **Meetings**

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

### **Minutes**

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

### **Evaluation**

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

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or to assure compliance with laws and regulations or the Company's ethics policies.	
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## 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 (Board) 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.<sup>1</sup>

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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, with a copy to the Chair and Vice Chair of the TAC. The CWG will provide comments to the TAC subcommittees when PRRs, NPPRs or other actions have credit implications.

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#### 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 CWG include, but are not limited to:

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- Providing input to PRRs and NPPRs that impact credit in accordance with this Charter and Board approved credit policies
- Providing input to the ERCOT Creditworthiness Standards

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<sup>1</sup> Capitalized terms used in this document shall have the meanings ascribed to them in the ERCOT Protocols unless otherwise noted.

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

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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 w [...] [1]

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The CWG shall not engage in any activities that conflict with or violate ERCOT Protocols or the ERCOT Ethics Agreement.

The CWG shall 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 policies 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

Each Corporate Member of ERCOT may designate one employee that meets the Qualifications Guidelines for Credit Work Group Membership as a voting member to participate in the activities and attend meetings of the CWG. The Consumer representatives on the ERCOT Board may each designate one person, that meets the Qualifications Guidelines for Credit Work Group Membership, as a voting member to participate in the activities and attend meetings of the CWG.

All designations of CWG members must be sent to ERCOT's Credit Manager.

The Chair and Vice-Chair of the CWG shall be elected annually by the CWG membership and confirmed by vote of the Finance and Audit Committee.

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

In order to discharge its responsibilities, the CWG may form temporary or ad hoc task forces. The CWG Chair, with CWG approval, shall appoint the chair for each task force for a term of one year or the duration of the task force which ever is less. Each task force chair may serve in that role for no more than two consecutive one year terms. The CWG shall direct these task forces and make assignments as necessary.

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All task forces are responsible for reporting planned activities/projects and results to the CWG for review. All task force actions are subject to CWG review.

## **V. Meetings**

### ***A. Quorum***

In order to take action, a quorum must be present. At least one CWG member from four of the seven market Segments listed below must be present at a meeting to constitute a quorum: Independent REPs (and Aggregators), Independent Generators, Independent Power Marketers, Municipals, Cooperatives, Investor Owned Utilities, and Consumers.

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Each CWG member or CWG member's company represented on CWG may designate, in writing, an Alternate Member or proxy who may attend meetings and vote on the member's behalf. Alternate Members must be employees of same company as the CWG member designating them or may be agents with a contractual obligation to represent the interest of the Company designating them. Proxies shall not be counted toward establishing a quorum at a CWG meeting. If a CWG member wishes to designate an Alternate Member or proxy, the CWG member must send to ERCOT notification of the designation of such Alternative Member or proxy in advance of any meeting and the designation shall be valid for the time period designated by the CWG Member.

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**Comment [Credit1]:** Nick, this may be a problem...CWG did not require that proxies be existing CWG members.

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### ***B. Meeting Schedule and Notification***

The CWG shall meet at least quarterly to review credit policy. In addition, the CWG shall meet as needed to address issues as they arise such as PRRs or NPPRs as they are proposed or needed. Meeting notices and agendas shall be sent to the CWG distribution list and posted on the ERCOT website at least one (1) week prior to the CWG meeting unless an emergency condition requires shorter notice. Meeting notices for emergency meetings shall be sent to the distribution list and posted on the

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ERCOT website and shall clearly identify the condition requiring the shorter notice. Except in cases of emergency, all agenda items requiring a vote of CWG must be published at least one week prior to the meeting at which the vote will take place. In the case of an emergency, all agenda items requiring a vote of CWG shall be published as soon as possible prior to the meeting at which the vote will take place and the need for the emergency vote shall be clearly identified. All CWG meetings may be attended by any interested observer.

**C. Voting**

**Votes:** At all meetings, each Segment shall have one (1) vote. CWG members present at the meeting and participating in the vote shall receive an equal fraction of its Segment's vote.

**Abstentions:** In the event that a CWG member abstains from a vote, the Segment vote shall be allocated equally among the members casting a vote.

**Voting:** In matters determined by the CWG Chair to require a vote of CWG or when any CWG member requests a vote on an issue, each CWG member shall have one (1) vote except that a CWG member holding a valid proxy for another member shall have one (1) vote plus one vote for each proxy held. A motion passes when (A) a majority of the aggregate of the fractional Segment votes are: (i) affirmative, and (ii) a minimum total of three (3) and (B) a minimum of 67% of voting individuals meet Qualification guidelines.

**Comment [NF2]:** Suggest proxy holders be qualified as CWG members. If not, suggest at least: (a) proxies be granted only to employees of the same company or in same market segment as CWG member granting the proxy OR (b) an individual may only vote in 1 segment, regardless of # of proxies held.

Any dissenting party shall have the right to present its position to the Finance and Audit Committee if such dissenting party chooses to do so.

**E-mail voting:** An e-mail vote is permitted provided a Notification is distributed to the CWG distribution list. An e-mail vote is subject to the same Notification requirements as other votes unless it is procedural only or has been designated as an urgent vote. A Notification must include a detailed description of the issue or proposition on which the vote will occur. A request for an e-mail vote shall be initiated only by the CWG Chair. A quorum of CWG members must participate in the e-mail vote. Participation requires casting a vote or abstaining. Votes shall be submitted to ERCOT for tallying by the close of two (2) Business Days after ERCOT staff circulates the Notification of the vote. Votes are tallied

in the same manner as a regular meeting. The final tally shall be distributed to the CWG distribution list and posted on the ERCOT MIS.

**D. *Conduct of Meetings***

The CWG Chair, or Vice-Chair in the Chair's absence shall preside at all meetings and is responsible for preparation of agendas. In the absence of the CWG Chair or Vice-Chair, another CWG member shall preside at the meeting. The CWG members shall be guided by Robert's Rules of Order in the conduct of CWG meetings. ERCOT staff shall be responsible for recording minutes of CWG meetings and distributing and posting on the MIS the minutes and other communications to all CWG members and any other parties who express an interest in receiving such information. ERCOT staff shall endeavor to distribute and post the minutes of each meeting within seven days after the date on which the meeting took place. Generally, at the beginning of a CWG meeting, the minutes of the prior meeting shall be reviewed and approved by CWG.

CWG members and Alternate Members must meet the qualifications as identified on the attached Qualifications Guidelines for Credit Work Group Membership. The Finance and Audit Committee shall review the requirements for membership in the CWG annually.

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

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**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).

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## Qualification Guidelines for Credit Work Group Membership

Other than a Consumer CWG member, each CWG member must be an employee of a Corporate Member of ERCOT (as defined in the ERCOT By-Laws) in good standing. All CWG members and alternate members representing a Corporate Member must be actively engaged in or responsible for the credit activities of such Corporate Member.

All CWG members and alternate members must have experience in at least one or more of the following 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
- Finance and/or loan administration
- Credit ratings analysis
- Commercial credit analysis
- Financial analysis

CWG members are encouraged to be active participants on the CWG.

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.

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.

# Update on liquidity/liability management

## Cheryl Yager

**<Group Discussion>**

- **Audit field work commenced March 5, 2007**
- **No remarkable findings from PricewaterhouseCoopers staff**
- **Potential post-retirement healthcare benefit obligation not previously recognized**
  - Issue identified by management
  - Actuarial assessment of potential liability is underway and is expected to be completed in March
  - Impact on timing of finalization of the 2006 audit report
  - Possible accounting treatment includes
    - Disclosure only
    - Adjusting entries in 2006
    - Restatement of 2005 and adjusting entries in 2006
  - Future financial statement impact

- **Staffing adjustments**
  - Transition headcount
  - CEO hire
- **Facilities**
  - Austin office/control center issues
  - Taylor expansion / reconfiguration
- **Texas Regional Entity organization and responsibilities**
- **Independent Market Monitor support**

# Committee Brief - Credit

## Cheryl Yager

### ERCOT Market Credit Status

	as of 1/31/2007				as of 2/28/2007			
	# 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>								
<b><u>QSEs that meet ERCOT Creditworthiness Standards</u></b>								
Ratings over BBB-	5	21,784,950	7%	48,000,000	U	5	34,012,392	9%
<b><u>QSEs that do not meet ERCOT Creditworthiness Standards</u></b>								
Ratings below BBB- or not rated Cash & Letters of Credit Guarantee Agreements	44 13	107,326,901 195,088,214	33% 60%	228,675,970 440,442,122	S S	41 14	114,102,821 210,595,842	32% 59%
<b>Total Exposure</b>	<b>62</b>	<b>324,200,065</b>	<b>100%</b>			<b>60</b>	<b>358,711,055</b>	<b>100%</b>
<b>Other QSEs in the ERCOT Market (ERCOT owes)</b>								
<b><u>QSEs that meet ERCOT Creditworthiness Standards</u></b>								
Ratings over BBB-	13	(26,030,948)	-34%	106,028,345	U	13	(16,560,842)	-23%
<b><u>QSEs that do not meet ERCOT Creditworthiness Standards</u></b>								
Ratings below BBB- or not rated Cash & Letters of Credit Guarantee Agreements	45 9	(40,836,845) (9,613,285)	-53% -13%	30,356,751 185,200,000	S S	48 8	(38,858,162) (17,162,398)	-54% -24%
<b>Total</b>	<b>67</b>	<b>(76,481,078)</b>	<b>-100%</b>			<b>69</b>	<b>(72,581,401)</b>	<b>-100%</b>
<b>Total</b>		<b>129</b>				<b>129</b>		

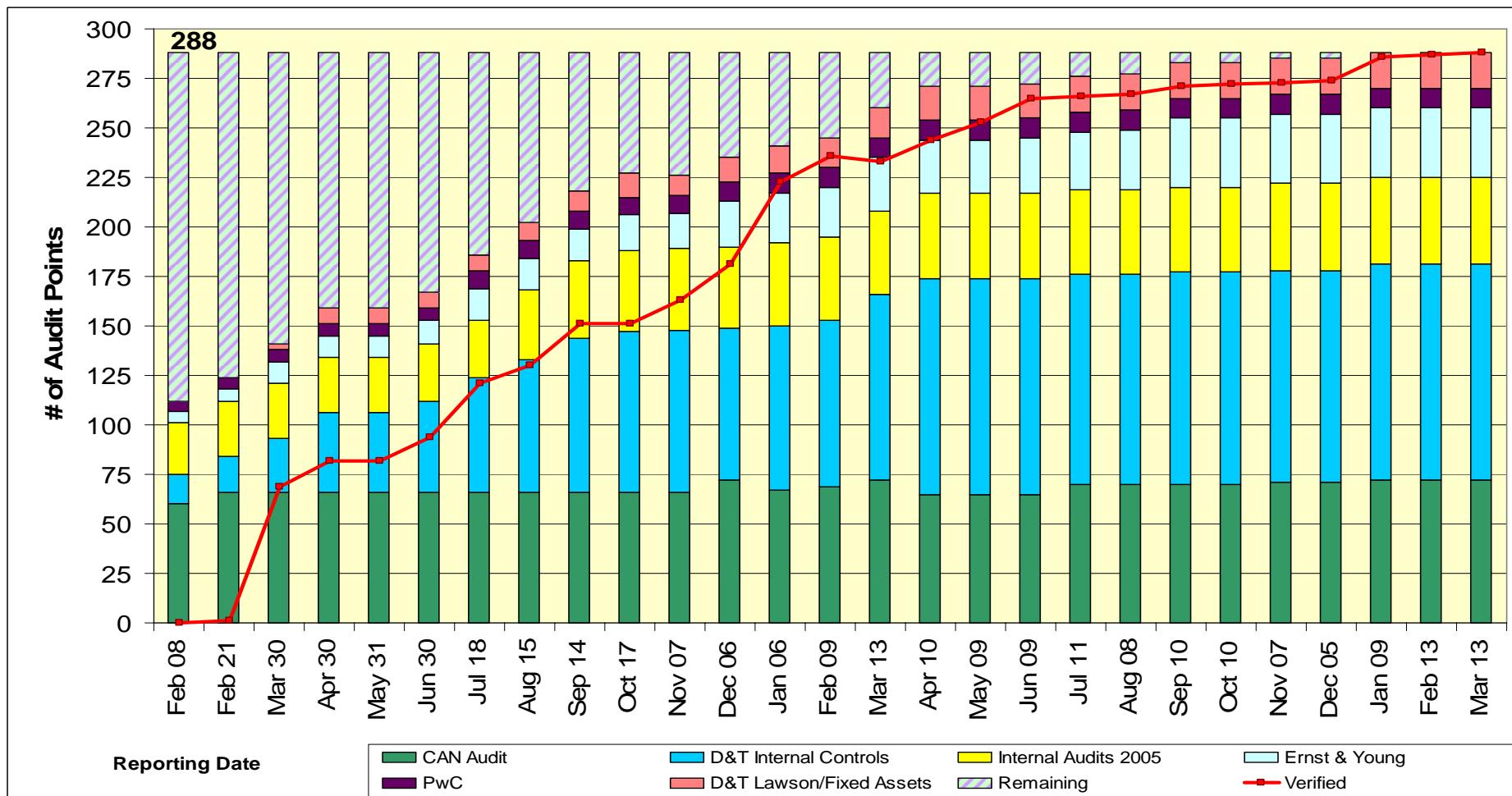
U: Unsecured since these QSEs meet the creditworthiness standards

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

**<No changes from last month's report>**

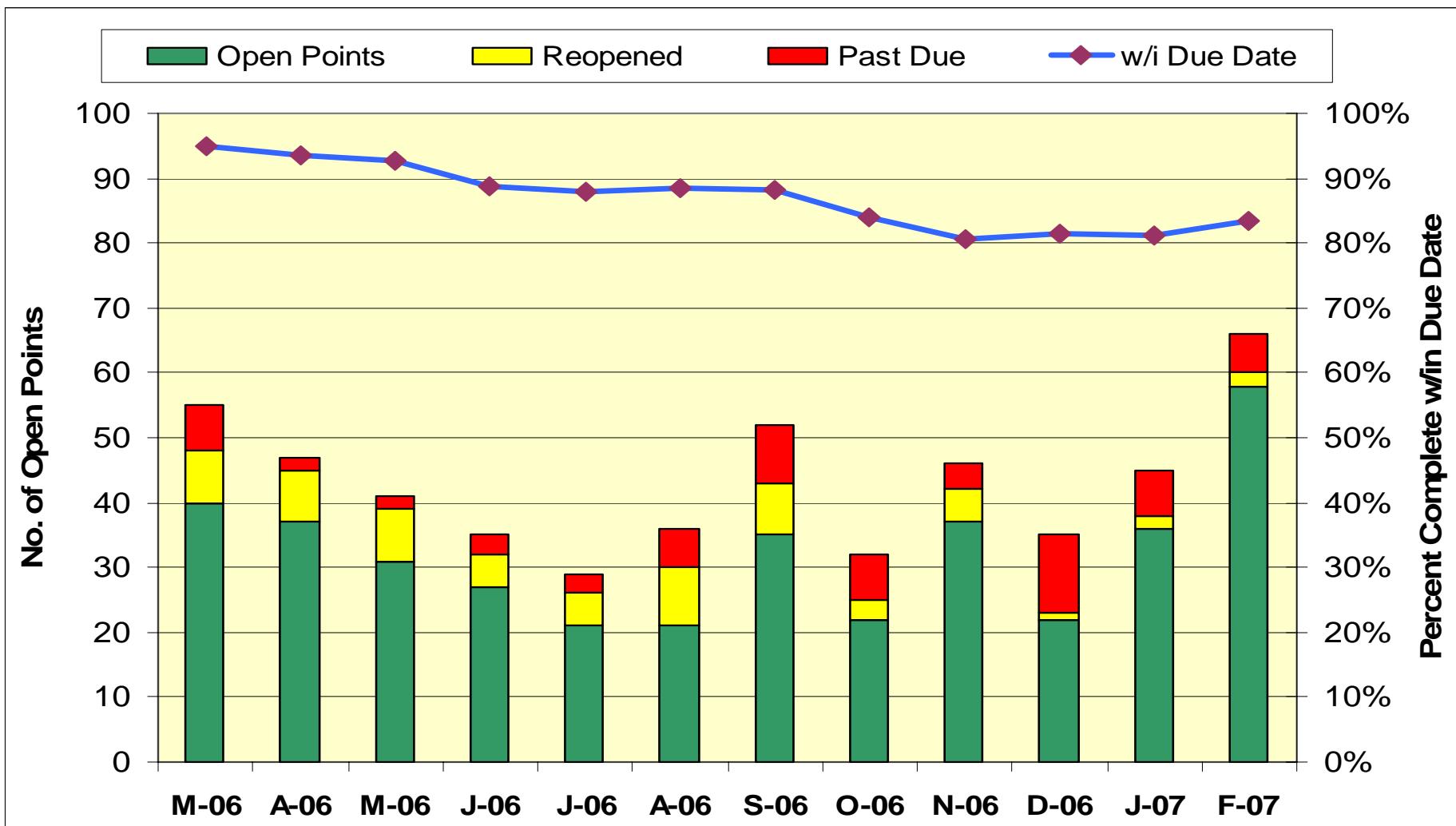
## Completion Status by Audit - 2004-05 Audit Points

288 complete & verified



# Committee Brief - ICMP

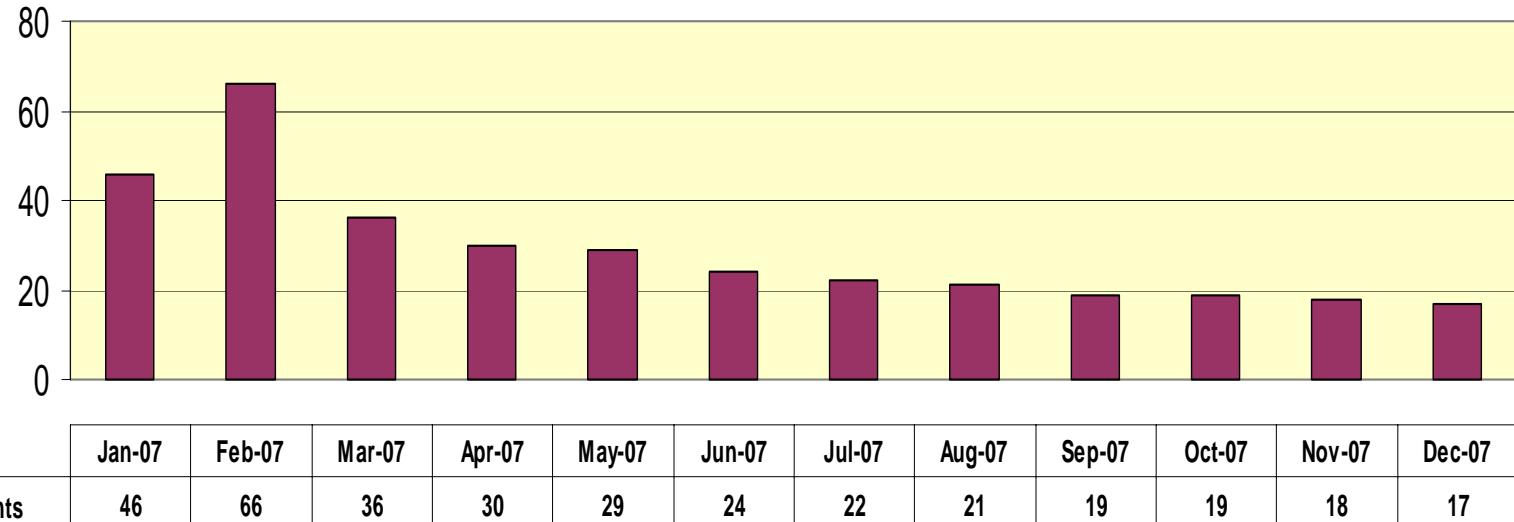
## Cheryl Moseley



Audits Completed	1	2	0	3	0	2	2	0	3	2	5	2
Points Added	11	5	0	15	0	7	30	2	28	8	36	35
Points Completed	27	13	6	21	6	0	14	22	14	19	26	14

## Projected Audit Point Progress

No. Remaining Items



## Audits Completed (last 3 months)

### Internal Audits

- Crisis Communication Procedures
- Business Continuity Plan
- Procurement & Contract Administration
- SCADA Applications
- Registration/Qualification of Market Participants
- Budget Process

### External Audits

- Texas Nodal Program Controls - Review #2 (IBM-managed by IAD)
- 2006 SAS70 (PwC)
- Internal Controls (D&T)

## Open Audits

### Internal Audits

- SAS70 Pre-Audit Testing
- Accounts Payable
- Nodal Timetracking
- Nodal Recruiting
- Nodal Signing Authority/Delegation of Authority
- Nodal Ethics Compliance
- PMO (Non-nodal)
- Procurement Short String Approval Process

### External Audits

- 2006 Financial Audit (PwC)
- 2007 SAS70
- 2006 Final MPP

## Planned Audits (next 3 months)

### Internal Audits

- Nodal PMO
- Protocol/Market Guide Approvals/Revisions
- Regional Entity Planning & Budget
- Contract Audit (21<sup>st</sup> Century)
- NERC Compliance (TRE & IAD)
- Congestion Mgmt. (TCRs)
- Nodal Acctg./Allocation

### External Audits

- Texas Nodal Program Controls – Review #3 - IBM (Managed by IAD)

- NOTE: Internal Audits performed by IAD, unless otherwise noted.

**Consultation/  
Analysis Reports  
Completed**  
(last 3 months)

**External Assessments**

- 3 security assessments completed in December
- 1 security assessment with combined consulting service completed in February

**Open Consultation/  
Analysis Reviews**

**External Assessments**

1 security assessment started in March

**Planned Consultation/  
Analysis Reviews**  
(next 3 months)

**External Assessments**

## 2007 Year to Date Project Activity by Division

	Phase	Not Started	Initiation	Planning	Execution	Closing	Completed	Cancelled	On Hold	Totals by CART	Go-Live*
CART	Corporate Operations	19	1	4	7	2	0	0	0	33	1
	IT Operations	7	0	1	6	0	0	0	1	15	0
	Market Operations	15	1	2	11	7	0	1	1	38	0
	System Operations	2	1	9	5	5	2	1	3	28	3
	<b>Totals by Phase</b>	<b>43</b>	<b>3</b>	<b>16</b>	<b>29</b>	<b>14</b>	<b>2</b>	<b>2</b>	<b>5</b>	<b>114</b>	<b>4</b>

\*NOTE: 3 project went live in the month of February. See subsequent slides in deck.

# Committee Brief – PMO

## David Troxell

### Year to Date Project Priority List (PPL) Status

PPL Iterations	Origination	Project Phases								Subtotal	Grand Total
		Not Started	Initiation	Planning	Execution	Closing	Completed	On Hold	Cancelled		
Original 2007 PPL										72	
	PUCT	1			1	1		2		5	
	Market	4	1	1	2	1		1	1	11	
	ERCOT	33	1	6	11			2	1	54	
	Compliance			2						2	
	System Maintenance									0	
Unexpected Carry Over From 2006										28	
	PUCT				1	1	1			3	
	Market	1			1	2				4	
	ERCOT			2	9	9	1			21	
	Compliance									0	
	System Maintenance									0	
New Projects Added (Since PPL Approval in August 2006)										14	
	PUCT		1							1	
	Market	2								2	
	ERCOT	2		5	4					11	
	Compliance									0	
	System Maintenance									0	
2007 PPL totals as of January 31, 2007										114	
	PUCT	1	1	0	2	2	1	2	0	9	
	Market	7	1	1	3	3	0	1	1	17	
	ERCOT	35	1	13	24	9	1	2	1	86	
	Compliance	0	0	2	0	0	0	0	0	2	
	System Maintenance	0	0	0	0	0	0	0	0	0	
Totals by Project Phase		43	3	16	29	14	2	5	2	114	

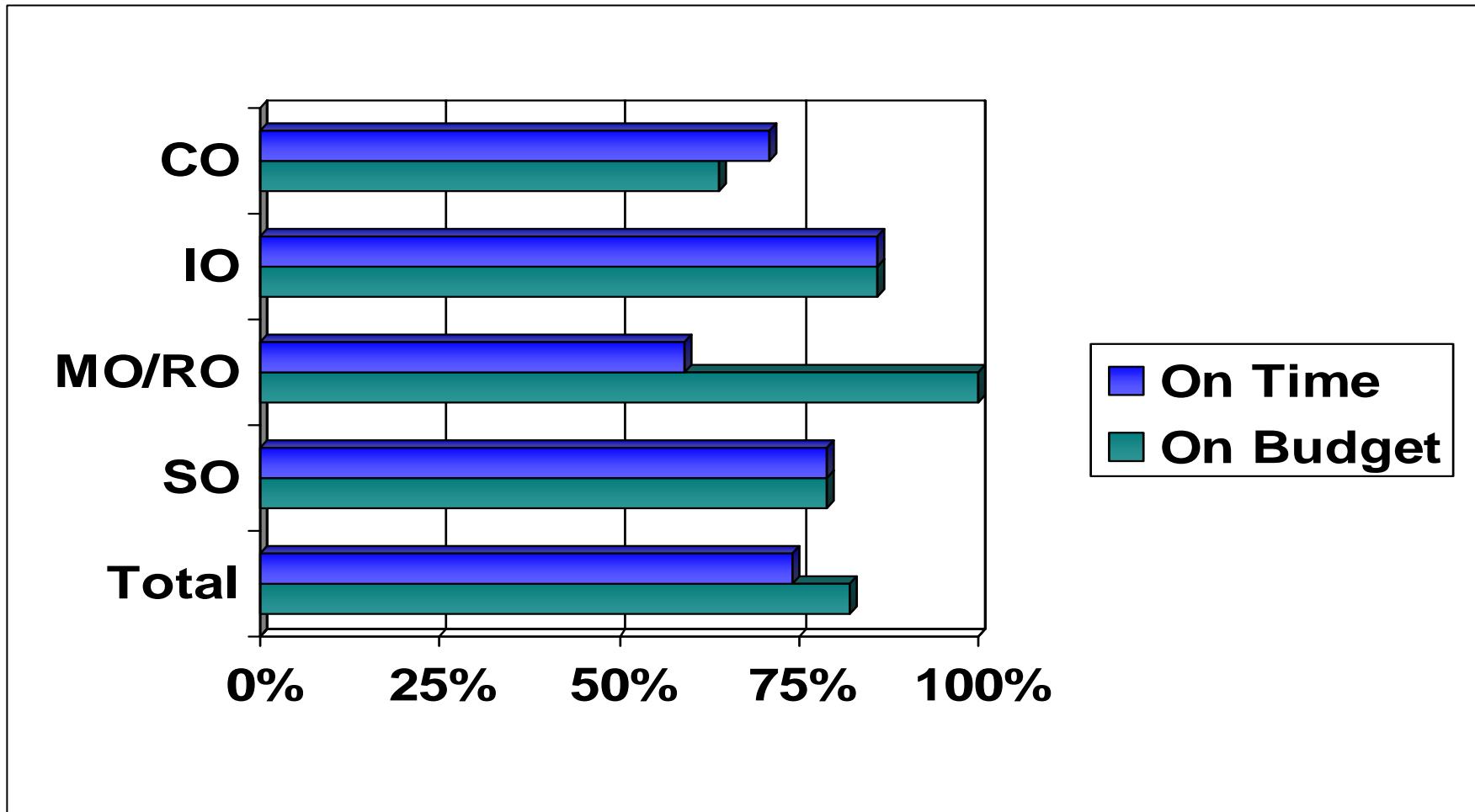
# Committee Brief – PMO

## David Troxell

### Projects Over \$1 Million

Projects Over \$1M	Total Budget	Committed Actuals 02/28/07	Metrics	
Duration/Information (Sponsor)	Phase/Scheduled Completion		Schedule	Budget
<b>(MO/RO) PR-40038_01: TX SET 3.0</b>	\$1.628M	\$.672M		
<i>Currently in Execution (R. Giuliani)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
<b>(SO) PR-40090_02:Operator Training Simulator (2005-2007)</b>	\$3.8M	\$2.540M		
<i>Training Simulator System for Operators (S. Jones)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
<b>(MO/RO) PR-50024_01:Enhancements to SCR727 (2005-2007)</b>	\$1.9M	\$1.422M		
<i>Entered into Execution (R. Giuliani)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
<b>(CO) PR-60099_01 TCC1 Build-Out Phase One</b>	\$2.362M	\$.012M		
<i>Currently in Planning ( S. Jones)</i>	<i>Expected Completion/3rd Qtr 2007</i>			

### 2007 Completed and Active Projects Performance



# Committee Brief – PMO

## David Troxell

### Capital Projects – Budget vs. Actuals for Projects Completed YTD

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ERCOT

Capital Projects - Budget vs. Actuals Comparisons for Projects Completed YTD

As of February 2007

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Completed Projects	Baseline Budget	Actuals	\$ (Over)/Under Baseline Budget	% (Over)/Under Baseline Budget	
PR-30105 (Congestion Management Reports)	105,300	86,716	18,584	18%	- 18,584
PR-60002_01 (Increase Number of Seats for Study Markets Clearing Engine)	179,823	86,718	93,105	52%	- 93,105 (2 projects)

NOTES:

- (a) Baseline Budget does not include change controls that were approved without granting a new baseline budget.

## Go Live Projects for February

- **PR-50130 SCE Performance Monitoring (PRR525)**
  - **Scope:** Provide ERCOT Compliance and Operations with tools which allow them to improve the measurement of QSE performance, maintain compliance with PRR525, and provide the capability to monitor QSE performance on a near real-time basis.
  - **Deliverables:** This project delivered ODS data archiving of performance data and a Cognos ReportNet interface for the SCE Performance Compliance Reports.
  - **Timeline:** July 2005 – February 2007

## Go Live Projects for February

- **PR-60014\_01 Vulnerability and Risk Management**
  - **Scope:** Investigate, select and design technology to identify and quantify vulnerabilities in order to mitigate risk in networks, applications, databases and systems within the ERCOT Enterprise Information Technology System.
  - **Deliverables:** Install commercial products onto the ERCOT network.
  - **Timeline:** February 2006 – *February 2007*

## Go Live Projects for February

- **PR-60084\_01 Mid Term Load Forecast Enhancements**
  - **Scope:** Secure an alternate source of Load Forecast information from Pattern Recognition Technologies (PRT)
  - **Deliverables:** This project delivered a one year subscription to PRT's ISOForecast and eLoadForecast services, and the ability to automatically download and archive the forecast data.
  - **Timeline:** July 2006 – February 2007

## Large Project Moving to Execution

- **PR-60055\_01 Enterprise Service Management**

- **Scope:** To deliver and implement a working, supportable, enterprise service management suite of applications in support of ITIL best practices
- **Deliverables:** Upgrade of Aperture Vista; establishment of a Configuration Management Database; new Service Desk, Release and Change Management applications; modify Altiris server management reports for Nodal; new application relationship mapping tools
- **Timeline:** April 2006 – December 2007
- **Board Request:** Cost expected to exceed \$1 million – seeking approval to move into execution

# Committee Brief – PMO

## David Troxell

### Enterprise Projects Summary Report

ERCOT Overall Projects Report						Reporting Period:	2/28/2007	YTD																																																																																								
Summary	ERCOT Projects Leadership		Projects in ERCOT's Portfolio			Portfolio Performance																																																																																										
	Executives		On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk																																																																																						
	Kent Saathoff	Ray Giuliani		5	3	16	29	14	Y																																																																																							
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## Future Agenda Items – April 2007

- Internal Audit Department Standing Report (Executive Session)
- Report by Credit Work Group Chair on ERCOT Credit Policy
- Vote on Credit Work Group Chair/Vice Chair
- Review proposed RFP for third party credit review
- Review results of annual audit (Vote to accept independent auditor's report)
- Debt financing and liability management (Vote)
- Quarterly investment performance update
- Committee briefs

## 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)
- ✓ •Required written communication and discussion of auditor independence
- ✓ •Review scope of annual financial audit
  - Report by CWG Chair on ERCOT credit policy
  - Vote on CWG Chair/Vice Chair

## 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)
- Review and approve ERCOT Annual Report
- Review operating plan and budget assumptions
- Review and approve Internal Audit Department Charter

## Quarter 3

- Appoint the independent auditors for upcoming year
- Approval of independent auditor fees for upcoming year
- Assessment of compliance, the internal control environment and systems of internal controls
- Review and approval of annual operating budget
- Report by CWG Chair on ERCOT credit policy
- Review updated year-end forecast

## 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 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 requirements for membership in CWG
- Review and approve CWG charter
- Review updated year-end forecast

## Recurring Items

- 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
- Review investment results quarterly