



**Date:** May 8, 2007  
**To:** Board of Directors  
**From:** Steve Byone, Vice President and Chief Financial Officer  
**Subject:** Authority for Additional Debt Financing

**Issue for the ERCOT Board of Directors**

**ERCOT Board of Director Meeting Date:** May 16, 2007

**Agenda Item No.:** 15c

**Issue:**

The Electric Reliability Council of Texas, Inc. (ERCOT) requires authorization from the ERCOT Board of Directors (the Board) to negotiate and execute the documents necessary to obtain debt financing of up to \$300 million.

This financing will be in addition to the 2002 Senior Notes (which have an outstanding balance as of May 16, 2007 of approximately \$96 million) and any TCR borrowings (which are primarily used for short-term intra-year working capital needs), but will pay off and replace the current term loan and revolving credit facility. The authorization requested herein will bring total authorized ERCOT debt financing to \$396,000,000, excluding any TCR borrowing.

ERCOT staff anticipates that the Finance & Audit Committee will recommend that the requested financing be obtained through a new term loan and revolving credit facility, and, in order to ensure that un-hedged, variable rate debt is not more than 40% of total debt outstanding, in accordance with the Financial Standard, will include entering into interest rate derivative products of up to \$130 million.

ERCOT currently has a term loan, with an outstanding balance of approximately \$25,000,000 (Term Loan), and a revolving credit facility, with an authorized amount of \$125,000,000 (Revolver). These facilities are not expected to be adequate to accommodate ERCOT's financing needs through the next two years. The requested new financing will pay off and replace these facilities.

In addition to paying off the Revolver and Term Loan, the requested financing will provide additional borrowing capacity to fund, on market terms and interest rates: (a) costs related to the Texas Nodal Market Implementation Program (TNMIP) which are not funded with the Nodal Surcharge through the development period, (b) capital expenditures from base operations not concurrently funded with the System Administration Fee, and (c) working capital needs.

The proposed authorized debt will include:

Term Loan (new)	\$ 225,000
Revolver (new)	<u>75,000</u>
<b>Proposed new borrowing capacity</b>	<b>300,000</b>



Senior Notes (balance as of May 16, 2007)	<u>96,000</u>
Total proposed authorized debt	\$ 396,000

**Background/History:**

In 2005, ERCOT was charged with implementing a multi-year effort undertaken by the Public Utility Commission of Texas (PUCT) and ERCOT stakeholders to re-design the Texas Electric Market, through the TNMIP. The estimated cost of TNMIP is currently \$248.9 million, including interest costs. ERCOT is currently collecting \$0.0663 per MWh under an interim Nodal Surcharge approved by the PUCT for implementation on an interim basis effective October 1, 2006. Based on the current estimated cost of \$248.9 million, ERCOT has filed for a permanent Nodal Surcharge of \$0.127 to be effective June 1, 2007. If approved, ERCOT estimates that this fee will fund approximately 32% of TNMIP costs through the development period. The remaining 68% of TNMIP costs is to be financed with debt. To date, the debt which has been incurred by ERCOT to finance TNMIP costs has been financed under existing credit facilities.

As ERCOT evaluated its financing needs in the Fall of 2006, it issued an RFP for Debt Financing to fund TNMIP costs as well as the debt portion of capital expenditures from base operations. The RFP was sent to five financial institutions: 2 banks, 2 Private Placement sources and National Cooperative Services Corporation (NCSC), at least one of which has a related entity that is a market participant. All affected financial institutions were made aware of the confidentiality and notice requirements ERCOT has regarding financial institutions that operate in the ERCOT market. As ERCOT considered the financing options below, it evaluated the options from the RFP responses considering cost and flexibility to meet ERCOT's needs.

At December 31, 2006, ERCOT had short term borrowings (which excludes Senior Notes and the Term Loan) of \$47 million under the Revolver. By December 31, 2007, ERCOT expects to require outstanding debt under the Revolver or new facilities of approximately \$165 million (assuming no TCR borrowings and excluding the current \$25 million Term Loan) and by December 31, 2008, ERCOT expects outstanding debt under the new facilities to be approximately \$195 million. This is based on estimated debt funding of TNMIP costs of approximately \$109 million and debt funding of capital expenditures from base operations of approximately \$39 million in 2007 and 2008. In addition, ERCOT is required per the Financial Standard to maintain a base level of availability under facilities to meet liquidity needs. Through 2008, this is expected to be up to an additional \$40 million. In summary, the \$300 million requested is to fund:

- |  |                |
|--|----------------|
| 1. Expected outstanding debt through December 31, 2008<br>(approx \$151 million of which will be from TNMIP) | \$ 195 million |
| 2. Refinance existing Term Loan<br>(at same terms, but to simplify the structure)                            | \$ 25 million  |
| 3. Provide for liquidity needs at end of 2008  | \$ 40 million  |
| 4. Provide for contingencies or to be used in 2009   | \$ 40 million  |



New borrowing capacity required

\$ 300 million

Finally, the Financial Standard requires that “in no event will ERCOT allow un-hedged, variable rate debt to be more than 40% of total debt outstanding”. This requirement mandates that a portion of the new debt issued must be fixed rate debt. To the extent variable rate bank debt is used to meet liquidity needs, interest rate swap(s) will need to be used to meet this requirement.

ERCOT staff considered various financing alternatives before settling on two primary financing strategies stemming from the results of the RFP:

Option 1 - Expanded or new bank facility with interest rate swap(s)

- Desire to incorporate a second bank to broaden access to bank market
- Total bank debt of up to \$300 million
  - \$225 million term loan
    - Includes refinancing existing \$25 million Term Loan
    - At least annual payments through November, 2012
    - Allow for prepayments without penalty
  - \$75 million revolving credit facility
    - Pay off outstanding balance under current \$125 million Revolver
    - Extend from current maturity in 2010 through 2012
- Up to \$130 million in interest rate swap(s)
  - To be executed through bidding process
  - Fairness opinion to be obtained
  - Will have income statement and balance sheet implications through 2012 with possible variability of \$7,000,000 or more

Option 2 – Private placement

- Up to \$175 million of senior notes under terms similar to existing 2002 Senior Notes
  - Fund approximately \$60-80 million at close and remainder as delayed draw by March 2008
  - Fixed annual pay down schedule to approximate expected revenues at slight discount
- \$25 million Term Loan – retain and payout
- \$75 to \$100 million Revolver
  - Reduce from \$125 million after final draw under new senior notes



Summary Comparison of Alternatives

	<u>Bank Debt w/ Swaps</u>	<u>Private Placement</u>
Pricing	<b>Comparable</b>	<b>Comparable</b>
Flexibility of terms	<b>More flexible</b>	Less flexible
Flexibility in obtaining amendments	<b>More flexible / more timely</b>	Less flexible / more formal process
Prepayment penalty	<b>No penalty on bank debt Potential gain or loss on swap(s)</b>	Yes, if negative No gain if positive
Ease of execution	<b>Easier</b>	Harder
Fix rate debt	Must execute interest rate swaps to "fix" the debt rate.	<b>Straightforward</b>
FAS 133 accounting valuations	Yes, must use FAS 133 accounting. May have valuation swings of \$3 - \$5 million over life of debt.	<b>No</b>

ERCOT staff reviewed both options in detail with the Finance and Audit Committee at a special meeting on May 4, 2007. After full discussion of the options, and variations thereof, the Finance and Audit Committee indicated a preference for Option 1 based on its competitive pricing and flexible structure. The Finance and Audit Committee will review the attached resolution at its May 16, 2007 meeting and is expected to formally vote on a recommendation at that time.

**Key Factors Influencing Issue:**

- Need to fund TNMIP costs not funded with the Nodal Surcharge during development
- Need to fund capital expenditures from base operations not funded with the System Administration Fee
- Need for additional financing to fund timing imbalances between revenue and expenses (working capital)

**Alternatives:**

- Increase Nodal Surcharge to fully fund TNMIP on a pay-as-you-go basis
- Increase System Administration Fee to fully fund capital expenditures on a pay-as-you-go basis



- Increase System Administrative Fee to build cash reserves sufficient to fund imbalances between cash income and expenses and fund Interest Reserve.
- Reduce spending for capital projects or other budgetary items
- Execute Private Placement or other financing alternates
- Execute expanded or new bank facility with interest rate swap(s)

**Conclusion/Recommendation:**

ERCOT staff recommends that the BOD authorize ERCOT to negotiate and execute the documents necessary to (a) obtain debt financing of up to \$300 million (in addition to the 2002 Senior Notes and TCR borrowings) and (b) enter into interest rate derivative products of up to \$130,000,000. The requested financing will replace existing revolving and term loan facilities and provide additional borrowing capacity to fund (a) costs related to the TNMIP which are not funded with the Nodal Surcharge during development, (b) capital expenditures from base operations not funded with the System Administration Fee, and (c) working capital needs, all on market terms and interest rates.



**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 increase ERCOT' borrowing capacity and negotiate and enter into a new advancing term loan facility with banks for up to \$225,000,000 in principal amount, possibly through a syndicated arrangement, with a term of up to five and one-half years, to be repaid in at least annual installments, at market terms and rates (Term Loan);

WHEREAS, the ERCOT Board deems it desirable and in the best interest of ERCOT, to negotiate and enter into a revolving credit facility with banks for up to \$75,000,000 in principal amount, possibly through a syndicated arrangement, with a term of up to five and one-half years, at market terms and rates, for liquidity purposes (Revolver);

WHEREAS, the Term Loan and Revolver would pay and replace the term loan and revolving credit facility that ERCOT currently has in place, but would be in addition to the outstanding balance of the 2002 Senior Notes;

WHEREAS, the ERCOT Board deems it desirable and in the best interest of ERCOT to obtain fixed rate interest on up to \$130,000,000 of the floating rate \$225,00,000 Term Loan authorized herein;

And WHEREAS the ERCOT Board deems it desirable and in the best interest of ERCOT to negotiate and enter into interest rate derivative products (Interest Rate Agreements) with swap provider(s) for up to \$130,000,000;

THEREFORE, be it RESOLVED that:

1. The Term Loan, Revolver and Interest Rate Agreements described above are hereby authorized and approved in each and every respect;
2. ERCOT may enter into the Term Loan, Revolver and Interest Rate Agreements and that the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, and General Counsel/Corporate Secretary of ERCOT (Authorized Officers) are each hereby severally authorized to determine and approve the terms, conditions, and consideration of such transactions and to execute and deliver, in the name and on behalf of ERCOT, loan and other documentation evidencing and governing the Term Loan, Revolver or Interest Rate Agreements, including without limitation, a commitment letter, fee letter, credit agreement(s), all related promissory notes, all other related loan documentation and all interest rate hedging, swap or other related interest rate derivative documentation, all substantially in form and substance as shall be approved by the officer executing and delivering the same, such approval to be evidenced conclusively by such execution and delivery;



3. The obligations incurred upon such execution and delivery by ERCOT of the loan and other documentation evidencing and governing the Term Loan and Revolver shall be in all respects binding and enforceable obligations of ERCOT;
4. The obligations incurred upon such execution and delivery by ERCOT of the interest rate hedging, swap or other interest rate derivative documentation evidencing and governing the Interest Rate Agreements shall be in all respects binding and enforceable obligations of ERCOT;
5. The ERCOT Board severally designates, authorizes, and empowers each of the Authorized Officers (acting together or individually) to perform or cause to be performed, in the name of ERCOT, all acts and deeds, to pay or cause to be paid, on behalf of ERCOT, all related costs and expenses and to make, execute, and deliver, or cause to be executed and delivered, all such other agreements, consents, approvals, orders, applications, requests, demands, directions, certificates, undertakings, supplements, instruments, documents, further assurances, or other communications of any kind, with or without the corporate seal of ERCOT or otherwise, on behalf of ERCOT or otherwise as he or she may deem necessary, appropriate, or advisable to comply with the intent of the foregoing resolutions or to comply with the requirements of the instruments approved and authorized by the foregoing resolutions, including but not limited to, the loan and other documents evidencing and governing the Term Loan, Revolver or Interest Rate Agreements, and any other certificate, instrument, or document related thereto;
6. All acts and things whether heretofore or hereafter done or performed by any Authorized Officer of ERCOT which are in conformity with the intent and purposes of these resolutions, including but not limited to the execution and delivery of any and all agreements, amendments, supplements, instruments, documents or filings as may from time to time be required, such additional or specific authorizations shall be and the same are hereby in all respects ratified, confirmed, and approved, and adopted as acts by ERCOT; and
7. The Secretary of ERCOT is hereby authorized and empowered to certify to the passage of the foregoing resolutions with or without the seal of ERCOT or otherwise.