

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
Wullenjohn, William	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 that 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

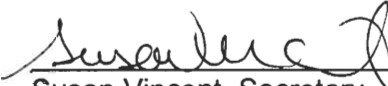
Mr. Karnei asked if any members had questions about the ERM materials. Mr. Espinosa asked if there were any significant changes in risk. Mr. Byone noted that several items had decreased in risk, and Mr. Karnei noted that Nodal was still red.

Future Agenda Items

Mr. Byone reviewed the list of future agenda items and asked if the members were interested in adding other topics. Mr. Byone indicated that Internal Audit had requested that the Internal Audit Department Charter be reviewed and approved at an upcoming Committee meeting. 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.


Susan Vincent, Secretary