

## MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Met Center

8:00 A.M.

July 17, 2007

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 8:00 A.M. on **July 17, 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	Unaffiliated Board Member	Unaffiliated Board Member	Present
Nick Fehrenbach	City of Dallas	Consumer	Not Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Michehl Gent	Unaffiliated Board Member	Unaffiliated Board Member	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present
William Taylor	Calpine Corporation	Ind. Generator	Present
Dan Wilkerson	Bryan Texas Utilities	Municipal	Present

#### Other Board Members and Segment Alternates:

Steve Bartley	CPS Energy	Municipal	Present
Robert Thomas	Green Mountain Energy	Ind. Retail Electric Provider	Present

#### ERCOT staff and guests present:

Anderson, Troy	ERCOT
Brenton, Jim	ERCOT
Byone, Steve	ERCOT
Campbell, Cassandra	ERCOT
Davies, Morgan	Calpine
DiPastena, Phil	ERCOT
Doolin, Estrellita	ERCOT
Hancock, Misti	ERCOT
Kahn, Bob	ERCOT
Petterson, Mike	ERCOT
Troxtehl, David	ERCOT
Vincent, Susan	ERCOT
Yager, Cheryl	ERCOT
Walker, DeAnn	ERCOT
Westbrook, Susan	ERCOT
Wullenjohn, William	ERCOT

### Executive Session

At 8:01 A.M., the Committee meeting was adjourned and the Committee went into Executive Session until 8:30 A.M., when the Committee returned to Open Session.

### **Approval of Previous Minutes**

Tom Standish noted that the minutes of the June 19 Committee meeting needed correction to indicate that he was not present. **Dan Wilkerson made a motion to approve the minutes of the Committee meeting held on June 19, 2007, subject to such correction; Mr. Standish seconded the motion. The motion passed unanimously.**

### **Credit Review Request for Proposal**

Clifton Karnei explained that while in executive session during the July 16, 2007, Special Committee Meeting, the Committee had discussed the proposals received from vendors in response to the Credit Review Request for Proposal ("RFP"). The Committee determined that, after careful consideration of the needs of the market, ERCOT credit, and the costs of the finalists, it would recommend to the Board that staff be authorized to proceed with negotiating a contract with a vendor to (1) perform a review and make "best practice" recommendations regarding market credit practices and (2) provide a model to aid in the analysis of credit risk and the adequacy of capital in the ERCOT market, as recommended by ERCOT staff. Because a contract had not yet been negotiated with the top vendor candidate, the Committee agreed to maintain confidentiality of the vendor's identity.

**Miguel Espinosa made a motion to recommend approval of the selected credit review vendor as described in and for up to the amount indicated in the Board template; Dan Wilkerson seconded the motion. The motion passed unanimously.**

### **Credit Working Group Update**

Morgan Davies reported that the Credit Work Group (CWG) is preparing an update to the ERCOT Creditworthiness Standards, which sets forth whether and to what amount a market participant may have unsecured credit. He explained that CWG had approved some "low hanging fruit" suggestions, including: (1) lowering the maximum unsecured credit allowed for market participants from \$125 million to \$100 million, (2) using Fitch ratings (along with Standards & Poor's and Moody's); (3) using Tangible Net Worth rather than straight Shareholder's Equity when setting maximum unsecured credit limits; and (4) establishing modified rules limiting amount of maximum unsecured credit allowed under foreign guarantees when quarterly financials are not provided. Mr. Davies noted that the Board would need to approve any modifications to the Creditworthiness Standards and that CWG planned to bring its initial recommendations for Committee consideration and Board review in August or September. He committed to review the proposed changes with TAC prior to bringing them to the F&A Committee. Mr. Karnei asked that CWG report back after meeting with TAC, to notify the Committee of TAC input, comments, and concerns, by segment. William Taylor noted that, because TAC did not have to approve the standards, no formal feedback by segment would be possible.

Mr. Taylor asked Ms. Yager about the additional staff referred to in the materials. Ms. Yager indicated that some of the changes to the Creditworthiness Standards being considered by CWG includes taking into consideration qualitative as well as quantitative factors. Mr. Davies noted that using qualitative factors is now considered best practice and is being used or considered at other ISOs and is supported by FERC, for entities that are FERC jurisdictional. Ms. Yager wanted to ensure that the Committee was aware that ERCOT was not currently staffed to accommodate this change and has not included it in the 2008 budget request. If this change is made and ERCOT considers qualitative factors, at least one additional staff would be required. Ms. Yager confirmed to Mr. Taylor that this determination would likely not be completed before the 2008 budget process was complete.

Finally, Mr. Davies explained that CWG expected to recommend additional changes to the Creditworthiness Standards at a future date. He noted that the CWG was also considering options to transfer risk out of the market, through tools like credit derivatives or insurance.

Cheryl Yager noted that the implementation of Texas SET 3.0 in late June complete the currently planned activities to reduce credit risk in the market. With this implementation, the timeframe to move an entity out of the market was reduced by around 4-5 days (thus making the entire Mass Transition process around 10–12 days).

### **Quarterly investment performance update**

Ms. Yager summarized the investment results from the 2<sup>nd</sup> quarter with the Committee, noting that there had been no substantial changes. In response to inquiry, Ms. Yager noted that ERCOT was holding \$124 million in collateral deposits as of June 30, and that the interest received on these deposits is passed through to the market participants who post the deposits.

### **Preliminary 2008 Budget Review**

Mike Petterson provided the Committee with an overview of the preliminary 2008 draft Budget, explaining that staff was trying to give a clear view of 2008 and a vision of 2009 and 2010. He told the Committee that, as communicated to the Board several times in recent months, there continues to be upward pressure on the fee, and there is still significant uncertainty regarding the long-term operational and financial implications of transitioning to a Nodal market model. However, he informed the Committee that management proposes:

- the 2008 ERCOT System Administration fee remain flat at \$0.4171 per MWh
- the Nodal program surcharge remain at \$0.1270 per MWh in 2008
- all other charges and fees collected by ERCOT remain unchanged in 2008

Miguel Espinosa requested clarification of the budget impacts shown at slide 4 of Mr. Petterson's presentation. Mr. Petterson offered an explanation, and agreed to include the clarification before the slide is posted on ERCOT's website.

Mr. Petterson and Mr. Byone discussed the many staff requests by line managers which were declined and adjustments made to the 2008 budget in order to avoid the need for a rate increase and the attendant time and money that would be involved in a rate case. Mr. Byone said that many managers were not pleased about the reductions in staff additions which were being denied by management, but they were trying to manage their budgets to help allow the fee to remain flat. Mr. Byone explained to the Committee that the 2008 Budget benefited from the transfer of all NERC fees and Texas Regional Entity operating costs for federal work as these cost were no longer paid from the System Administration fee. He also noted that, to the extent feasible and based upon resource availability, staff was trying to accelerate certain planned 2008 capital projects into 2007 so that these could be completed using available 2007 capital funds.

Mr. Gahn questioned whether ERCOT's current cost recovery method is mandated by statute or PUC rules, since the billing determinants didn't seem to make sense for an entity whose costs are not load-sensitive. Mr. Karnei suggested that management try to raise the issue of the fee basis with the PUC.

Mr. Espinosa asked if the Commission had seen the budget yet, and Mr. Byone explained that, since the materials were only completed the previous Friday, they had not yet visited with the Public Utility Commission about this draft budget. The Committee discussed headcount, and Mr. Byone explained that the Nodal Program staff included some employees as well as consultants. Mr. Karnei confirmed with Mr. Petterson that management now expected to require additional staff in the Nodal (post-2008) market.

Mr. Wilkerson requested that Mr. Petterson provide a 5-year budget forecast at the August Committee meeting, noting that at the current spend rate, Nodal funding would be exhausted by this time next year. Mr. Karnei noted that budget predictions for 2009 and beyond are subject to significant uncertainty about additional staffing and operating expenses needed to operate under a nodal market structure. Mr. Wilkerson noted the fact that MWh were increasing at a lower rate than salaries were increasing and this would continue to cause upward pressure on the System Administration fee for 2009 and beyond.

Mr. Byone confirmed for the Committee that that the 5-year budget projection would be available and they could further discuss the proposed 2008 budget with the benefit of more detail at the Special Meeting that was scheduled for August 7, 2007.

Mr. Wilkerson noted that, with the moderate weather, the ERCOT revenues were down, causing additional rate pressure. Mr. Gahn noted that the reason ERCOT originally thought it could keep the System Administration fee flat was because of the expected increase in MWh. Mr. Karnei asked all members to let Mr. Byone know if they had any additional data request or comments on items included in the draft budget, prior to the August 7 Special Meeting.

### **Committee briefs (Q&A only)**

#### **Project Update - Identity & Access Management**

David Troxtell reported that the Identity Access Management project would not be completed within its contract deadline and the cost will likely exceed the original budget of \$1.4 million. ERCOT plans to terminate the contracts for IAM development due to vendor quality and cost problems. Mr. Troxtell told the Committee that the project team was re-looking at the project, and that the IT Development Director was anticipating completing the project by using ERCOT employees and staff augmentation. He confirmed that a full briefing on the project will be provided at the August meeting.

Mr. Karnei reminded the members that the IAM project was intended to provide an automated solution to a SAS70 audit finding regarding certification procedures. Jim Brenton indicated that his staff would do a manual certification of access, pending completion of the automated system, in order to be SAS70 compliant.

Ms. Yager introduced Phil DiPastena, ERCOT's new Enterprise Risk Manager.

#### **Future Agenda Items**

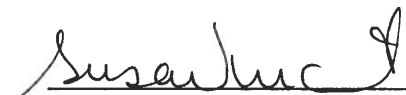
Mr. Espinosa noted that Nancy Capezzuti's report on enhanced background investigation and hiring practices should be added as an agenda item for the next meeting.

Mr. Byone reminded the Committee that Sean Barry from PricewaterhouseCoopers would attend the August meeting and update the Committee on the SAS70 progress.

#### **Adjournment**

At 9:32 A.M., the Committee meeting was adjourned.

The next regular Committee meeting will be held on the morning of Tuesday, August 21, 2007.

  
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Susan Vincent, Secretary