



Date: January 8, 2008
To: ERCOT ISO Board of Directors
From: Steve Byone, Chief Financial Officer, Ron Hinsley, Chief Information Officer
Subject: Nodal Budget and Surcharge Filing

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: January 15, 2008

Agenda Item No.: 7

Issue: ERCOT forecasts that the total cost of the Texas Nodal Market Implementation Program (Nodal Program) (excluding financing costs and “Interdependent Projects”) will be approximately \$269.1 million. This amount is more than 10% higher than the Nodal Program budget authorized by the ERCOT Board of Directors (Board) in January 2007. Associated financing costs through the recovery period are expected to increase from \$33.5 million to a range of approximately \$42.2 million to \$56.4 million -- depending on the timing of recovery of the forecasted additional costs. ERCOT requests that the Board:

- (1) Approve a revised budget for the Nodal Program in the amount of \$269.1 million together with associated financing costs of \$42.2 million, resulting in a new total to be recovered via the Nodal Surcharge of \$311.3 million.
- (2) Authorize ERCOT to make a filing with the Public Utility Commission of Texas (PUC), in accordance with the June 13, 2007 Order Nunc Pro Tunc in Docket No. 32686, to request an increase in the amount to be recovered via the Nodal Surcharge from \$248.9 million to \$311.3 million and to request a change in the Nodal Surcharge rate from \$0.127 per megawatt-hour (MWh) to \$0.169 per MWh, effective no later than June 1, 2008.
- (3) Approve a revised budget for the Interdependent Projects of \$39.7 million, an increase of \$2.7 million over the January 2007 projection for those items, which are part of the overall Nodal Program budget but are not recovered via the Nodal Surcharge.

See Summary of Proposed Nodal Program Budget Changes (attached as Exhibit A) for reconciliation to the current authorized budget.

Background/History: In September 2003, as part of Project No. 26376, the PUCT instructed ERCOT to replace its existing zonal wholesale market design with a nodal design. ERCOT began work on the Nodal Program once the PUCT approved the Nodal Protocols during April 2006 in Docket No. 31540.

ERCOT must be able to recover the Nodal Program costs in a timely manner. At the outset of the Nodal Program, by letter dated November 22, 2005, ERCOT notified the PUCT of its intent, subject to PUCT approval, to utilize \$5.1 million in unspent funds from the 2005 budget



to support the initial costs associated with the Nodal Program. The PUCT approved ERCOT's request at its December 1, 2005 Open Meeting.

At the March 21, 2006 Board meeting, the Board authorized ERCOT to file a request with the PUCT to implement an interim nodal surcharge (Nodal Surcharge) or other mechanism allowing ERCOT to recover costs incurred for the Nodal Program. On May 5, 2006, ERCOT filed its initial application to the PUCT, in Docket No. 32686, to establish an interim Nodal Surcharge allowing ERCOT to collect expenses related to the Nodal Program and allowing the Program to progress as ERCOT prepared cost estimates and a budget. On August 29, 2006, the PUCT issued an interim order in Docket No. 32686 authorizing ERCOT to begin collection of an interim Nodal Surcharge of \$0.0663 per MWh imposed on all qualified scheduling entities (QSEs) representing Generation Resources.

On January 16, 2007, the Board:

- (1) authorized a Nodal budget of \$215.4 million (excluding "Interdependent Projects" and associated financing costs) and associated financing costs of \$33.5 million, resulting in a total of \$248.9 million to be recovered via the Nodal Surcharge; and
- (2) authorized ERCOT to file a request with the PUCT for the establishment of a long-term Nodal Surcharge to recover Nodal Program cost.

ERCOT filed that request on January 29, 2007. After due consideration and a hearing, the PUCT issued an Order dated May 23, 2007 and an Order Nunc Pro Tunc dated June 13, 2007 in Docket No. 32686 (Orders), authorizing a Nodal Surcharge of \$0.127/MWh, excluding the "Interdependent Projects," on a flat-fee basis. The Orders require ERCOT to assess the Nodal Surcharge to QSEs representing Generation Resources, multiplying the surcharge factor of \$0.127/MWh by the total net metered generation aggregated to the QSE level. The Order Nunc Pro Tunc authorizes ERCOT to initiate PUCT proceedings to change the Nodal Surcharge (rate) if the change to the Nodal Program cost estimate leading to the request is more than 10% higher than the approved \$248.9 million.

Following issuance of the Orders, the Nodal Program proceeded through completion of the design phase into the current implementation phase and is approximately eleven months from completion. To help ensure a high-quality, robust system allowing for flexibility for ERCOT Market Participants, ERCOT did not rely upon a single vendor for the nodal market systems but, instead, selected vendors based upon "best of breed" status. Because the selected systems (energy management system, market management system, network model, congestion revenue rights, *etc.*) must conform to the Nodal Protocols, the integration among the various systems was more complex than originally anticipated. Moreover, additional changes were required to complete the project, such as increased infrastructure needs, Protocol changes to provide a better functioning market and additional efforts in market readiness and testing.

When considering alternatives for recovery of costs through the Nodal Surcharge in the original filings, ERCOT Staff prepared and the Finance and Audit Committee of the BOD reviewed



several scenarios for funding the Nodal Program. The scenarios encompassed a range of options available for funding the Nodal Program. In all scenarios, the full cost of the Nodal Program was to be recovered no later than the end of the estimated average useful life of the assets. The BOD and the PUCT approved a Nodal Surcharge based on the “flat fee” scenario.

Key Factors Influencing Issue:

A. Forecasted increase in Estimate at Completion for the Nodal Program.

ERCOT needs authorization to increase the Nodal Program budget in order to keep the Nodal Program on schedule.

B. Recovery of additional Nodal Program costs:

ERCOT considered the same factors considered in previous filings:

- (1) Impact on ERCOT’s financial position. Higher debt levels can negatively impact ERCOT’s balance sheet. Higher levels of revenue funding via the Nodal Surcharge strengthen ERCOT’s balance sheet.
- (2) Overall cost of the Nodal Program. The more debt incurred, the more interest cost ERCOT must pay and, thus, the higher the overall cost of the Nodal Program.
- (3) Matching of the payment for the Nodal Program via the Nodal Surcharge with the benefit from the Nodal Program once it is in place.
- (4) Desire to minimize “spiking” in the Nodal Surcharge. The need or desire to have a consistent, predictable fee that will not fluctuate significantly.

Alternatives:

A. Forecasted increase in Estimate at Completion for the Nodal Program.

- (1)
 - (a) Approve the revised Nodal Program budget of \$269.1 million and associated financing costs of \$42.2 million resulting in a total of \$311.3 million.
 - (b) Approve the revised budget for the Interdependent Projects of \$39.7 million.
- (2) Refrain from approving the revised Total Nodal Program budget, pending further information required by the Board, and accommodate the delay by eliminating or delaying certain parts of the Nodal Program.

B. Recovery of additional Nodal Program costs.



- (1) Authorize ERCOT to request an increase in the existing Nodal Surcharge from \$0.127 per MWh to \$0.169 per MWh until all Nodal Program costs are recovered (expected to be through 2012). This option anticipates using a blend of borrowed funds and the Nodal Surcharge to maintain a flat fee from mid 2008 through 2012 (the remainder of the development period and the estimated average useful life of the assets). This option would result in an increase in financing costs calculated through the end of the expected recovery period of approximately \$8.7 million (from \$33.5 million to \$42.2 million). The portion of the Nodal Program funded during development would decline from approximately 31.5% under the existing authorization to approximately 27.5% with this alternative.
- (2) Maintain the Nodal Surcharge at \$0.127 per MWh and extend the expected period to collect the fee through mid 2014. Under this alternative, 100% debt would be used to finance the additional costs. This alternative would result in an increase in financing costs through the recovery period of approximately \$22.9 million, from \$33.5 million to \$56.4 million. The portion of the Nodal Program funded during development would decline from approximately 31.5% under the existing authorization to approximately 23.5% with this alternative. This alternative yields a total amount to be recovered via the Nodal Surcharge of \$325.5 million (excluding Interdependent Projects).

Conclusion/Recommendation: ERCOT recommends alternatives A.(1) and B.(1).

ERCOT requests that the Board approve a revised budget for the Nodal Program of \$269.1 million with associated financing costs of \$42.2 million resulting in a total amount to be recovered via the Nodal Surcharge of \$311.3 million and approve a revised budget for the Interdependent Projects of \$39.7 million.

In addition, ERCOT seeks authority from the Board to make a filing with the PUCT, in accordance with the June 13, 2007 Order Nunc Pro Tunc in Docket No. 32686, to request an increase in the amount to be recovered via the Nodal Surcharge from \$248.9 million to \$311.3 million and to request a change in the Nodal Surcharge rate from \$0.127 per megawatt-hour (“MWh”) to \$0.169 per MWh, effective no later than June 1, 2008.

The proposed approvals appear in the Resolution shown in Attachment A.



Exhibit A

Summary of Proposed Nodal Budget Changes

	Authorized Budget	Estimate at Completion
Total Program budget	\$263.0	\$319.4
Less:		
Interdependent projects	37.0	39.7
Capitalized Interest costs	10.6	10.6
	<hr/>	<hr/>
Nodal costs to be financed	215.4	269.1
Plus:		
Debt financing costs	33.5	42.2
	<hr/>	<hr/>
Costs recoverable via Nodal Surcharge*	\$248.9	\$311.3
* Fee Impact	\$0.127	\$0.169



Attachment A

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

WHEREAS, the Electric Reliability Council of Texas, Inc. (ERCOT) Board of Directors (Board) deems it desirable and in ERCOT’s best interest for a source of funding to cover the revised costs ERCOT will incur related to implementing the Texas Nodal Market Implementation Program (Nodal Program), and

WHEREAS, ERCOT must request approval by the Public Utility Commission of Texas (PUCT) for ERCOT to collect a fee in the form of a surcharge assessed in addition to its System Administration Fee (or some other comparable mechanism) to pay for Nodal Program costs ERCOT incurs, and

WHEREAS, the PUCT, in its Docket No. 32686, approved ERCOT’s nodal market implementation surcharge (Nodal Surcharge) in 2007, and

WHEREAS, ERCOT now needs to increase the budget for the Nodal Program to a total of \$269.1 million plus the associated financing costs of \$42.2 million resulting in a total of \$311.3 million (excluding Interdependent Projects) to be recovered via the Nodal Surcharge.

THEREFORE, BE IT RESOLVED, the Board hereby approves the revised Nodal Surcharge budget of \$269.1 million plus the associated financing costs of \$42.2 million for a total of \$311.3 million and the revised Interdependent Projects budget of \$39.7 million. The Board finds this is a reasonable forecast of ERCOT’s costs of nodal market implementation, and

RESOLVED FURTHER, the Board authorizes ERCOT to make a filing at the PUCT requesting authority in accordance with the June 13, 2007 Order Nunc Pro Tunc in Docket No. 32686, to increase the amount to be recovered via the Nodal Surcharge from \$248.9 million to \$311.3 million and to request a change in the Nodal Surcharge rate from \$0.127 per megawatt-hour (“MWh”) to \$0.169 per MWh effective no later than June 1, 2008.

CORPORATE SECRETARY’S CERTIFICATE

I, _____, Assistant Corporate Secretary of ERCOT, do hereby certify that, at the _____, 200____ ERCOT ISO Board of Directors Meeting, the Board of Directors of ERCOT approved the above-referenced Resolution. The Motion passed by _____.

IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____, 200____.

Assistant Corporate Secretary