

**DIRECT TESTIMONY OF**

**STEVE BYONE**

**VICE-PRESIDENT AND CHIEF FINANCIAL OFFICER**

**ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.**

**IN SUPPORT OF**

**ERCOT'S APPLICATION FOR APPROVAL**

**OF A REVISED NODAL MARKET**

**IMPLEMENTATION SURCHARGE**

1                                   **DIRECT TESTIMONY OF STEVE BYONE**

2  
3   **Q.     PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

4   A.     My name is Steve Byone. My business address is 7620 Metro Center Drive,  
5           Austin, Texas 78744.

6  
7   **Q.     BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8   A.     I am employed by the Electric Reliability Council of Texas, Inc. ("ERCOT") as  
9           Vice-President and Chief Financial Officer ("CFO"). I began my employment at  
10          ERCOT in 2005. I was appointed to my current position in September 2005.

11  
12   **Q.     PLEASE DESCRIBE YOUR RESPONSIBILITIES AS CHIEF FINANCIAL**  
13           **OFFICER.**

14   A.     I am responsible for all treasury functions including financing, cash management,  
15           and credit analysis. I also oversee all accounting operations including accounts  
16           receivable, accounts payable, fixed assets, financial reporting, and  
17           budgeting/forecasting. Additionally, I oversee the company's procurement, (non-  
18           Nodal) Project Management Office, and enterprise risk management functions.  
19           Finally, I am responsible for management of the \$100 million-plus corporate  
20           operating budget and I am the primary liaison between the Finance and Audit  
21           Committee of the Board of Directors and ERCOT.

22  
23   **Q.     PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL**  
24           **QUALIFICATIONS.**

25   A.     I have a Bachelor of Science degree in Accounting and Business Administration  
26           from Northwestern State University in Natchitoches, Louisiana. I also have a  
27           Masters of Business Administration, with a concentration in finance, from  
28           Louisiana Tech University. I am also a Certified Public Accountant. I have more  
29           than 25 years experience in the energy field in a wide variety of positions,  
30           including Vice-Presidential positions as Chief Financial Officer and Chief Risk  
31           Officer. Prior to joining ERCOT, I was a Vice-President and Chief Risk Officer

1 for Progress Energy, a Fortune 250 diversified energy company with more than  
2 24,000 megawatts of generation capacity and \$9 billion in annual revenues.  
3 Before Progress Energy, I held a number of positions with Mirant Corporation,  
4 including Co-Chief Commercial Officer and Director of Corporate Finance &  
5 Chief Risk Officer for Mirant Europe, and Vice-President and Chief Control  
6 Officer with Mirant Americas Energy Marketing. In these positions, I had a  
7 number of responsibilities, including a primary role in the launch of a European  
8 venture, where I oversaw development of corporate, legal, and tax structures;  
9 secured working capital funding; developed business processes; and spearheaded  
10 hiring of staff. Earlier in my career, I held significant management and technical  
11 positions with Enron Corp., including managing world-wide cash flow, managing  
12 interest rate exposure and managing treasury stock repurchases. I also filled key  
13 roles in finance, accounting, and risk management before leaving Enron Corp. in  
14 1996.

15  
16 **Q. HAVE YOU EVER TESTIFIED BEFORE THE PUBLIC UTILITY**  
17 **COMMISSION OF TEXAS?**

18 A. Yes, I testified in Docket 31824 (ERCOT's 2006 System Administration fee case)  
19 and in Docket No. 32686 (ERCOT's request for approval of the Nodal Program  
20 surcharge).

21  
22 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

23 A. The purpose of my testimony is to provide support for ERCOT's request to revise  
24 the Nodal surcharge to \$0.169 per MWh.

25  
26 **Q. PLEASE EXPLAIN HOW ERCOT IS FUNDING THE TEXAS NODAL**  
27 **MARKET IMPLEMENTATION PROGRAM.**

28 A. ERCOT is funding the Texas Nodal Market Implementation Program ("TNMIP"  
29 or "Nodal Program") by means of a special purpose surcharge approved by the  
30 Commission in Docket No. 32686. In approving the Nodal surcharge, the  
31 Commission made the following findings:

- 1 • “ERCOT will charge the final Nodal surcharge to Qualified Scheduling Entities  
2 (“QSEs”) representing generation resources, multiplying the surcharge factor of  
3 \$0.127/MWh by the total net metered generation aggregated to the QSE level.”<sup>1</sup>  
4
- 5 • “The use of the flat-fee method is appropriate as it preserves ERCOT’s target  
6 debt ratio, balances the lowest interest costs with payment by those who benefit  
7 from the Nodal-market implementation, and provides a stable fee with minimal  
8 spiking during the collection period”.<sup>2</sup>  
9

10 ERCOT began assessing the \$0.127/MWh Nodal surcharge on June 1, 2007. The  
11 approved Nodal surcharge is scheduled to be collected until ERCOT recovers the  
12 costs necessary to implement the Nodal market – originally estimated to continue  
13 through 2012.  
14

15 **Q. WHAT AMOUNT OF NODAL PROGRAM COSTS IS THE \$0.127/MWh**  
16 **SURCHARGE DESIGNED TO COLLECT?**

17 A. The Nodal surcharge is designed to recover \$248.8 million, which represents  
18 ERCOT’s early 2007 Estimate at Completion (“EAC”) for the Nodal Program plus  
19 the costs of financing the Nodal market implementation, in part, with debt.  
20

21 **Q. DID THE COMMISSION’S ORDER APPROVING THE NODAL**  
22 **SURCHARGE CONTEMPLATE A POSSIBLE CHANGE IN THE**  
23 **SURCHARGE BEFORE COMPLETION OF THE NODAL PROGRAM?**

24 A. Yes. When it provided its Nodal Program cost estimates in Docket No. 32686,  
25 ERCOT cautioned that program costs may change due to various factors.<sup>3</sup> The  
26 Commission recognized the possibility that the Nodal surcharge may require

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<sup>1</sup> Docket No. 32686, *Order*, at 8 (FOF 20) (May 23, 2007).

<sup>2</sup> *Id.* at 7 (FOF 17).

<sup>3</sup> This was a point I emphasized in my direct testimony in Docket No. 32686: “If Nodal Program costs turn out to be significantly lower or higher than estimated, ERCOT may request an adjustment to reflect those changes. As indicated in the testimony of the various project managers, numerous events could increase the cost of completing the Nodal Program. ERCOT’s ability to retain qualified employees, manage numerous vendors working on complex projects and keep dozens of inter-related software design, development and testing projects on schedule could all have significant financial impacts on the Nodal Program – and each could require an upward revision in the estimated cost to complete the Nodal transition.” Docket No. 32686, Direct Testimony of Steve Byone on Behalf of ERCOT (Phase II) at 10 (Jan. 29, 2007).

1 adjustment. In its Orders in Docket No. 32686, the Commission provided guidance  
2 regarding requests for revisions to the Nodal surcharge:

- 3 • “ERCOT may initiate Commission proceedings to change the Nodal surcharge  
4 only if the change in the Nodal Program cost estimate leading to the request is  
5 more than 10 percent higher or lower than the amounts presented in this  
6 proceeding.”<sup>4</sup>
- 7  
8 • “In future proceedings in which ERCOT requests to change the Nodal surcharge,  
9 ERCOT may use the modified ERCOT Fee Filing Package format adopted in  
10 Order Nos. 12 and 14 in this docket.”<sup>5</sup>
- 11

12 **Q. HAS THE NODAL PROGRAM COST ESTIMATE INCREASED BY MORE**  
13 **THAN 10 PERCENT ABOVE THE ESTIMATE PRESENTED IN DOCKET**  
14 **NO. 32686?**

15 A. Yes. The total authorized budget for the Nodal Program at the time the Commission  
16 issued its Order in Docket No. 32686 was \$263 million. The cost of “Zonal/Nodal  
17 Interdependent Projects” (totaling \$37 million at that time) was excluded from the  
18 amount to be paid for by the Nodal surcharge, along with \$10.6 million in  
19 capitalized interest costs. After subtracting these exclusions, the total amount of  
20 Nodal Program costs to be financed by the surcharge was \$215.4 million. When  
21 debt financing costs of \$33.4 million were added to the costs to be financed, the total  
22 costs recoverable from the Nodal surcharge was \$248.8 million.

23 The ERCOT Board of Directors approved a revised budget for the Nodal  
24 Program at its January 16, 2008 meeting.<sup>6</sup> The Board resolution authorizing the  
25 change states that ERCOT needs to “increase the budget for the Nodal Program to a  
26 total of \$269.1 million, plus associated financing costs of \$42.2 million resulting in a  
27 total of \$311.3 million (excluding Interdependent Projects) to be recovered via the  
28 Nodal surcharge.”<sup>7</sup>

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<sup>4</sup> Docket No. 32686, *Order Nunc Pro Tunc*, at 2, Ordering Paragraph 1a (June 13, 2007).

<sup>5</sup> *Id.*, Ordering Paragraph 1b.

<sup>6</sup> The January 2008 ERCOT Board of Directors Resolution is attached to my testimony as Attachment SB-1.

<sup>7</sup> Attachment SB-1, January 2008 Board of Directors Resolution. The Board also approved a revised Zonal/Nodal Interdependent Projects budget of \$39.7 million. As noted above, the Commission excluded the cost of the Interdependent Projects from the amount of the Nodal Program budget financed by the Nodal Surcharge. See Docket No. 32686, *Order*, at 7 (FOF 8-11).

1           The amount ERCOT must recover from the Nodal surcharge is now \$311.3  
2 million, which is an increase of more than 10 percent over the \$248.8 million  
3 ERCOT can recover from the current Nodal surcharge.  
4

5   **Q. HOW DOES ERCOT PROPOSE TO REVISE THE NODAL SURCHARGE**  
6   **TO RECOVER THE INCREASED NODAL PROGRAM COSTS?**

7   A. ERCOT does not believe it can prudently proceed with the Nodal Program without  
8 requesting an increase in the Nodal surcharge. Projected cost increases are  
9 significant enough to affect ERCOT's ability to fund them and therefore warrants  
10 revisiting the Nodal surcharge amount. Therefore, ERCOT requests that the  
11 Commission authorize it to increase the existing Nodal surcharge to \$0.169 per  
12 MWh. This represents an increase of \$0.042 per MWh over the current approved  
13 surcharge of \$0.127 per MWh. ERCOT does not propose any other changes in the  
14 key elements of the Docket No. 32686 Nodal surcharge order, namely, the recovery  
15 period of the Nodal surcharge (through 2012), the allocation of the surcharge (to  
16 QSEs representing generation resources), or in ERCOT's obligation to make filings  
17 with the Commission to account for the final costs and revenues associated with  
18 Nodal market implementation.<sup>8</sup>

19           The changes in the Nodal Program budget described above and their impact  
20 on the costs recoverable via the Nodal surcharge are summarized in Table 1:

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<sup>8</sup> See Docket No. 32686, *Order Nunc Pro Tunc*, at 2 (Ordering Paragraph 1c): "ERCOT shall file with the Commission within 12 months after the Nodal market 'goes live' and again within 12 months after ERCOT stops collecting the Nodal surcharge an accounting of the costs and revenues of implementing the Nodal market."

**Table 1: Summary of Nodal Budget and Proposed Surcharge Revision**

	<b>Docket No. 32686 Authorized Budget</b>	<b>January 2008 Authorized Budget</b>
	(\$ millions)	(\$ millions)
Total Program Budget	\$263.0	\$319.4
Less:		
Interdependent Projects	37.0	39.7
Capitalized Interest Costs	<u>10.6</u>	<u>10.6</u>
Nodal Costs to be Financed	215.4	269.1
Plus:		
Debt Financing Costs	<u>33.4</u>	<u>42.2</u>
Costs Recoverable via Nodal Surcharge*	\$248.8	\$311.3
Fee Impact*	\$ 0.127	\$ 0.169

**Q. HAS ERCOT CONSIDERED OTHER METHODS OF COST RECOVERY BESIDES INCREASING THE NODAL SURCHARGE?**

A. Yes. Since the inception of the Nodal Program, ERCOT has considered several ways to finance Nodal transition activities, ranging from paying for the entire development cost through a surcharge collected on a pay-as-you-go basis to financing 100 percent of the project development cost with debt and establishing a surcharge to service the debt after program implementation. In Docket No. 32686, ERCOT proposed (and the Commission approved) a “flat-fee” approach, which includes a combination of borrowed funds and a surcharge that is intended to balance the recovery of the program implementation costs over the period 2006-2012.

**Q. WHAT WERE THE PRINCIPAL FACTORS AND GOALS ERCOT CONSIDERED WHEN EVALUATING THE DIFFERENT OPTIONS FOR FUNDING THE INCREASED COSTS OF THE NODAL PROGRAM?**

A. When reviewing various funding options in the context of the increases in Nodal Program costs, ERCOT gave special consideration to: (1) the impact on ERCOT’s financial position; (2) the overall cost of the Nodal Program (including financing costs); (3) matching the revenue collected for payment of the Nodal Program with the benefit from the program once it is in service; and (4) the desire

1 to minimize “spiking” in the surcharge. These were the same factors ERCOT  
2 considered when it originally recommended the flat-fee structure of the Nodal  
3 surcharge.  
4

5 **Q. PLEASE EXPLAIN WHAT YOU MEAN BY THE “IMPACT ON**  
6 **ERCOT’S FINANCIAL POSITION?”**

7 A. Higher debt levels negatively impact ERCOT’s balance sheet and thus tend to  
8 weaken the company’s financial position. Likewise, higher levels of revenue  
9 funding strengthen ERCOT’s balance sheet. It is important for ERCOT to  
10 maintain a strong financial position to provide the ability to finance unexpected  
11 future expenditures which may be required to maintain reliability and/or market  
12 services and to provide debt funding at a reasonable cost and thereby mitigate the  
13 overall cost of ERCOT services.  
14

15 **Q. DO DIFFERENT FUNDING OPTIONS IMPACT THE OVERALL COST**  
16 **OF THE NODAL PROJECT EQUALLY?**

17 A. No. Funding options that call for lower amounts of revenue funding and therefore  
18 require greater amounts of debt financing necessarily result in higher interest  
19 costs and thus the overall cost of the transition to a Nodal market is increased.  
20

21 **Q. WHY DID YOU CONSIDER IT NECESSARY TO COMPARE THE**  
22 **TIMING OF REVENUE COLLECTED FOR PAYMENT OF THE**  
23 **PROGRAM WITH THE TIMING OF EXPECTED BENEFITS TO BE**  
24 **RECEIVED FROM THE PROGRAM?**

25 A. It is appropriate to compare the timing of revenue collected for payment of the  
26 Nodal Program with the timing of expected benefits to be received from the  
27 Program to determine the reasonableness of the matching of payment for Program  
28 development costs with benefits from the Program. Assuming a non-static  
29 marketplace, large up-front payments (i.e. revenues collected in advance of  
30 Program implementation) may cause a disproportionate share of the costs to be  
31 borne by parties other than those who benefit once the Nodal market is



1 implemented. Likewise, delaying payment for Program development costs  
2 beyond the useful life of the assets would have a similar effect.  
3

4 **Q. WHAT IS THE ANTICIPATED DEVELOPMENT PERIOD FOR THIS**  
5 **PROJECT?**

6 A. The project plan supports a development period for the Program which extends  
7 from 2006 through 2008.  
8

9 **Q. HAVE YOU ESTIMATED THE AVERAGE EXPECTED USEFUL LIFE**  
10 **OF THE ASSETS TO BE USED IN THE NODAL MARKET**  
11 **IMPLEMENTATION AND OPERATION?**

12 A. Yes, I estimate that the Nodal market assets' average expected useful life is four  
13 years, from 2009 through 2012.  
14

15 **Q. WHY IS IT IMPORTANT TO MINIMIZE "SPIKING" IN THE NODAL**  
16 **SURCHARGE?**

17 A. "Spiking" refers to an inconsistent, unpredictable fee that will fluctuate  
18 significantly. To minimize spiking is to produce stable, predictable fees that are  
19 desirable since they generally lead to lower business risk to Market Participants;  
20 presumably, lower business risk leads to lower cost to serve consumers.  
21

22 **Q. BASED ON YOUR ANALYSIS OF THESE FACTORS, WHAT**  
23 **ALTERNATIVES DID YOU CONSIDER FOR THE UPWARD REVISION**  
24 **OF THE NODAL SURCHARGE?**

25 A. Our analysis indicates that the flat-fee approach to Nodal funding is still the most  
26 prudent way to fund the Nodal Program. A shift to a 100 percent revenue or 100  
27 percent debt approach is not appropriate for protecting ERCOT's financial  
28 position, for containing Nodal costs, or for preventing spikes in the surcharge. In  
29 addition, a change in the structure of the Nodal surcharge at this point would  
30 disrupt Market Participants' expectations about the structure and timing of the  
31 surcharge. Based on these considerations, ERCOT considered two primary

options for revising the Nodal surcharge: (1) the \$0.042 per MWh increase proposed here (from \$0.127 per MWh to \$0.169 per MWh); and (2) extending the collection period for the existing Nodal surcharge (from 2012 to 2014).

**Q. WHAT ARE THE CONSEQUENCES OF CHOOSING ONE OF THESE ALTERNATIVES OVER THE OTHER?**

A. The primary differences involve three factors: (1) the amount of the surcharge; (2) the impact on ERCOT's debt load; and (3) the amount of program costs funded through the development period. The impact of the two alternatives on these factors is depicted in Table 2 below.

**Table 2: Comparison of Nodal Surcharge Alternatives**

	<b>Current Nodal Surcharge</b>	<b>Alternative 1: Increase Nodal Surcharge</b>	<b>Alternative 2: Extend Collection Period</b>
	(\$ millions)	(\$ millions)	(\$ millions)
Nodal Costs to be Financed	\$215.4	\$269.1	\$269.1
Debt Financing Costs	\$33.4	\$42.2	\$56.4
Costs Recoverable via Nodal Surcharge	\$248.8	\$311.3	\$325.5
Expected Nodal Surcharge	\$0.127/MWh	\$0.169/MWh	\$0.127/MWh
Projected end of Collection Period	Dec. 2012	Dec. 2012	Sept. 2014
Estimated "Peak" Debt (Related to Nodal)	\$149.7	\$199.3	\$208.3
Funding During Development	31.5%	27.4%	23.5%

As shown in Table 2, Alternative 1 would increase 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 Nodal surcharge revenues 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 \$33.4 million to \$42.2 million). The portion of the Nodal Program funded during development would decline from

1 approximately 31.5% under the existing authorization to approximately 27.4%  
2 with this alternative.

3 Alternative 2 would maintain the Nodal surcharge at \$0.127 per MWh and  
4 extend the expected collection period through late 2014. Under this alternative,  
5 100% debt would be used to finance the additional program costs, because  
6 ERCOT would not collect any additional revenue funding from the surcharge.  
7 This alternative would result in an increase in financing costs through the  
8 recovery period of approximately \$22.9 million, from \$33.4 million to \$56.4  
9 million. The portion of the Nodal Program funded during development would  
10 decline from approximately 31.5% under the existing authorization to  
11 approximately 23.5% with this alternative. This alternative yields a total amount  
12 to be recovered via the Nodal Surcharge of \$325.5 million (excluding  
13 Zonal/Nodal Interdependent Projects).  
14

15 **Q. WHAT ASSUMPTIONS DID ERCOT MAKE THAT RESULTED IN THE**  
16 **TOTAL PROPOSED INCREASE OF \$0.042 PER MWh INCLUDED IN**  
17 **OPTION 1?**

18 A. The key assumptions are similar to those ERCOT used to calculate the Nodal  
19 surcharge approved in Docket No. 32686. The increased Nodal Program budget  
20 did not fundamentally alter the assumptions underlying the Nodal surcharge  
21 calculation. ERCOT continued to assume that the Nodal Program would be  
22 funded during its development phase with a balance of debt financing and revenue  
23 “pay as you go” funding from the Nodal surcharge with the debt incurred during  
24 development and the related interest costs repaid over the estimated average  
25 useful life of the assets. The use of debt financing obviously requires that the  
26 overall cost estimate include debt service interest as a cost of the Nodal Program.  
27 The specific key assumptions are as follows:

- 28 • The total Nodal Program costs recoverable through the Nodal surcharge  
29 (excluding debt service interest costs) are approximately \$269.1 million,  
30 allocated \$52.7 million in 2006, \$112.3 million in 2007, \$102.5 million in  
31 2008, and \$1.6 million in 2009.  
32

- Debt financing rates (5.5 percent for 2006 borrowings and 6.0 percent after 2006) included in are the same as those Docket No. 32686.
- Principal repayment is assumed to be accomplished by the end of the average useful life of the assets developed. The average useful life of hardware and software assets developed is assumed to be four years (2009 – 2012).
- Energy consumption (GWhs or MWhs) is assumed at the levels included in ERCOT's 2008 budget.
- The effective date of the revised Nodal surcharge is assumed to be June 1, 2008

**Q. WOULD CHANGES TO THESE ASSUMPTIONS CHANGE YOUR ESTIMATE OF THE AMOUNT OF THE REVISED NODAL SURCHARGE?**

A. Yes. Significant changes to any of these assumptions would generate a different level of Nodal surcharge under Alternative 1 (*i.e.*, an increased surcharge recovered over the existing recovery period ending in 2012). If, for example, energy consumption in Texas is far enough below the estimate, it could result in the Nodal surcharge coming up short, since it is charged on a per MWh basis. Similarly, significantly different interest rate assumptions would cause ERCOT to revisit the amount of the revised Nodal surcharge.

**Q. WHAT IS THE IMPACT OF CHANGES IN THE EFFECTIVE DATE OF THE REVISED NODAL SURCHARGE?**

A. Each month the proposed revised Nodal surcharge is delayed, ERCOT is using debt financing to fund Nodal Program costs that would, if the revised Nodal surcharge was in place, otherwise be paid for by surcharge revenues. This causes the amount of debt service associated with the Nodal Program to increase, thereby increasing the total amount that must be recovered via the Nodal surcharge. Since the debt service amount increases without concomitant increases during the months when the revised Nodal surcharge awaits implementation, the delay also affects ERCOT's debt/revenue ratio.

1 **Q. HOW SIGNIFICANT ARE THESE IMPACTS ON A MONTH-TO-**  
2 **MONTH BASIS?**

3 A. As noted above, ERCOT recommends the Commission approve implementation  
4 of a revised Nodal surcharge of \$0.169 per MWh effective on June 1, 2008. The  
5 impact of faster or slower implementation is depicted in Table 3 below, with  
6 ERCOT's recommended June 1, 2008 alternative highlighted. The detailed  
7 calculations underlying the summary information in Table 3 are found in  
8 Workpapers 1.3-1.7 filed as par of ERCOT's Application.

9  
10 **Table 3: Summary Comparison of Revised Nodal Surcharge Implementation**  
11 **Dates (June – October 2008)**  
12

Implementation Date	Surcharge (\$ per MWh)	Revenue Contribution During Development	Costs to be Financed (\$ Millions)	Debt Financing Costs (\$ Millions)	Total Recoverable Cost (\$ Millions)
<b>June 1, 2008</b>	<b>\$0.169</b>	<b>27.4%</b>	<b>\$269.1</b>	<b>\$42.2</b>	<b>\$311.3</b>
July 1, 2008	\$0.170	26.8%	\$269.1	\$42.5	\$311.6
August 1, 2008	\$0.171	26.4%	\$269.1	\$42.8	\$311.9
Sept. 1, 2008	\$0.172	25.9%	\$269.1	\$43.0	\$312.1
Oct. 1, 2008	\$0.173	25.6%	\$269.1	\$43.2	\$312.3

13  
14 As depicted in Table 3, each month of delay in implementation of ERCOT's  
15 proposed revised Nodal surcharge causes an increase in the surcharge amount  
16 needed to maintain the flat-fee structure and in an overall increase in the total cost  
17 recoverable from the revised Nodal surcharge. In recommending Alternative 1,  
18 ERCOT is cognizant of the decline in the level of revenue funding provided  
19 during development. However, given the current stage in the development  
20 timeline and the proportion of program spending which has already occurred, a  
21 significant surcharge increase would be necessary to maintain the previous target  
22 revenue funding ratio of 30% or more. While revenue funding of 30% or greater  
23 is preferable, ERCOT recommends Alternative 1 as it provides the best  
24 compromise among the stated objectives. As depicted in Table 3, a delay in  
25 implementation of a revised flat-fee Nodal surcharge beyond June 2008 creates

1 increased risk regarding ERCOT's ability to maintain prudent debt/revenue ratios  
2 for the Nodal Program.

3  
4 **Q. WHAT IS THE STATUS OF THE ZONAL/NODAL INTERDEPENDENT**  
5 **PROJECTS THAT ARE EXCLUDED FROM THE NODAL**  
6 **SURCHARGE?**

7 A. In Docket No. 32686, ERCOT identified certain projects "relating to zonal market  
8 operations that are required to be completed before ERCOT can begin  
9 implementation of the Nodal market."<sup>9</sup> The Commission found that "it is  
10 appropriate for ERCOT to exclude the costs of the Zonal/Nodal dependencies  
11 from the Nodal market implementation budget."<sup>10</sup> The Nodal surcharge does not  
12 recover the costs of the Zonal/Nodal projects since those projects were necessary  
13 irrespective of the transition to a Nodal market, but, because those projects must  
14 be completed as part of the Nodal transition, and managed within the Nodal  
15 Program scope by the Nodal Program organization, they are a part of overall  
16 Nodal Program costs. As depicted in Table 1, the cost of the Zonal/Nodal  
17 projects has increased by \$2.7 million since the Nodal surcharge was approved.  
18 Thus, a total of \$39.7 million attributable to the Zonal/Nodal projects is deducted  
19 from the Program costs recoverable from the surcharge, rather than the \$37  
20 million deduction approved in Docket No. 32686.

21  
22 **Q. DID ERCOT CONSIDER REVISING THE ALLOCATION OF THE**  
23 **NODAL SURCHARGE TO QSEs REPRESENTING GENERATION?**

24 A. ERCOT does not recommend changes in the Nodal surcharge allocation at this  
25 time for three reasons. First, the Commission made an explicit determination in  
26 Docket No. 32686, after much debate among the parties to that case, to allocate  
27 the Nodal surcharge to QSEs representing generation. ERCOT has implemented  
28 the Commission's decision, and does not seek to re-open the allocation issue as  
29 part of its request to revise the surcharge. Second, keeping the allocation of the

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<sup>9</sup> Docket No. 32686, *Order*, at 7 (FOF 8).

<sup>10</sup> *Id.* (FOF 11).

1 surcharge the same causes the least disruption possible to Market Participants.  
2 While an increase in the Nodal surcharge is necessary, ERCOT does not believe it  
3 is advisable to also disturb industry expectations about how the surcharge is  
4 collected. Third, based on input from the Commission in Project No. 34889,<sup>11</sup>  
5 ERCOT is gathering information regarding fee allocation options that it plans to  
6 provide as part of its next System Administration Fee filing. Once the  
7 Commission has reviewed that analysis, a more informed determination may be  
8 made about whether any new allocation methodology should be applied to the  
9 remaining life of the Nodal surcharge.

10  
11 **Q. WHY DOES ERCOT RECOMMEND ALTERNATIVE 1 – THE**  
12 **INCREASE IN THE NODAL SURCHARGE TO \$0.169 PER MWh?**

13 A. Alternative 1 is superior for three reasons. First, increasing the revenue generated  
14 by the surcharge limits the amount of financing costs ERCOT must incur to fund  
15 the remaining costs of the Nodal transition. The increased financing costs  
16 associated with Alternative 1 are \$14.2 million less than the financing costs  
17 associated with Alternative 2. This means that under Alternative 1, the overall  
18 cost to complete the Nodal Program is significantly less. It also means that  
19 ERCOT's overall debt load increases less to achieve the same outcome  
20 (completion of the Nodal transition) than it would under Alternative 2. One of  
21 ERCOT's key financial objectives is to maintain a prudent debt ratio for all of its  
22 activities.

23 Second, Alternative 1 matches recovery of Nodal Program costs more  
24 closely to the development period and useful life of the assets. For the reasons  
25 discussed above, it is a financially sound practice – and more equitable to those  
26 funding any program – to recover costs during the useful lives of the assets  
27 involved. Third, the increase will maintain a flat-fee surcharge through the  
28 remaining recovery period. ERCOT certainly would prefer not to increase the  
29 surcharge, and is cognizant of the burden additional fees place on Market

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<sup>11</sup> Project No. 34889, *Rulemaking Related To Allocation of the Administrative Fee of the Electric Reliability Council of Texas*.

1 Participants and Texas electric consumers. However, a one-time increase to a  
2 stable funding level avoids spikes in the surcharge that would be caused by using  
3 an all-revenue approach to collecting increased Nodal Program costs. In addition,  
4 while Alternative 1 increases the Nodal surcharge, it maintains the existing  
5 collection period the market has been aware of since the Commission approved  
6 the surcharge.

7 As discussed above, if the implementation date of the revised Nodal  
8 surcharge is unduly delayed, ERCOT would need to revisit its recommendation  
9 based on the impact on its debt/revenue ratios. With that caveat, however,  
10 ERCOT strongly recommends the approval of Alternative 1.

11  
12 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY AT THIS TIME?**

13 **A.** Yes, it does.