



MEMORANDUM

To: Board of Directors
From: Mike Grable, General Counsel
Date: July 8, 2008
Re: July 15, 2008 Board Agenda Item 11(a) – Application of the 2007 Actual vs. Budget Revenue Requirement Variance

On June 17, 2008, ERCOT Director and Public Counsel Don Ballard proposed that the favorable 2007 financial variance of approximately \$2.5 million be distributed to retail electric customers negatively impacted by recent retail electric provider (REP) market exits and the resulting mass transitions to REP providers of last resort (POLRs). Because PUC Rule 25.43(k)(1)(A)(iii) sets a ceiling on POLR rates that is based on 130 percent of the market clearing price of energy (MCPE), it is likely that all or virtually all customers affected by recent mass transitions have paid higher rates for POLR service than they were paying to their prior REP.

Per the Board's request, I have researched whether any law, rule, or policy prohibits the Board from adopting the POLR proposal.

I have found no controlling authority on this issue in the Public Utility Regulatory Act (PURA), Public Utility Commission (PUC) Rules, or ERCOT's Articles of Incorporation or Bylaws. The ERCOT Financial Corporate Standard, in Section 3.0 (Financial Objectives), states that variances of more than 25 percent in the project budget, operating and maintenance budget, or revenue should be handled with "cost reductions or additions, fee increases or decreases, *or other means ...*" (emphasis added). Because this language is quite open-ended, and in any event applies only to much larger variances than the \$2.5 million at issue here, it is not a bar to the POLR proposal.

Therefore, unlike the System Benefit Fund and Energy Efficiency monies that are purpose-restricted and cannot be used for POLR rate relief (*see* PURA Sections 39.903 and 39.905), it appears that the POLR proposal is legally permissible.

Other Directors raised questions about the fairness of the POLR proposal, and/or whether it would set a precedent for future mass-transition events. I mention these concerns only to make clear that I have not been asked to, and will not, opine on whether the POLR proposal is the best application of the 2007 variance. However, the Board should be aware that ERCOT has no financial relationship with end-use retail customers, and no knowledge of the specific factual circumstances of each customer's situation (such as the customer's pre-POLR rate, the customer's POLR rate, and the length of time the customer was on POLR service). It may be that the Board would choose simply to give a predetermined amount of money to each POLR customer, or each POLR customer in a

certain class and/or service area. If, however, the Board wanted relief money to be more targeted to individual customers' POLR experience, a highly preliminary estimate by ERCOT Staff indicates that the cost of determining POLR-related costs per customer could exceed the amount of the favorable variance.

I look forward to discussing these issues with you next week.