



## ERCOT Finance & Audit Committee Meeting

**Hilton Austin Airport Hotel**  
**9515 Hotel Drive, Austin, Texas 78719, Wildflower Room**  
**April 18, 2007**  
**7:30 a.m. - 10:00 a.m.\***

Agenda Item #	Description/Purpose/Action Required	Presenter	Time
	Call to order	C. Karnei	7:30 a.m.
1.	Adjourn to Executive Session		
	• Review of Internal Audit Department Charter	B. Wullenjohn	7:30 a.m.
	• Internal Audit Department status report	B. Wullenjohn	7:40 a.m.
	• EthicsPoint update	S. Maslon	7:50 a.m.
	Reconvene to General Session		7:55 a.m.
2.	Approval of minutes (Vote) (3/21/07)	C. Karnei	7:55 a.m.
3.	Finance & Audit Committee Charter (Vote)	S. Vincent	8:00 a.m.
4.	Approval of Credit Workshop meeting minutes (Vote) (3/5/07)	C. Yager	8:10 a.m.
5.	Approval of Credit Work Group Charter (Vote)	M. Davies	8:20 a.m.
6.	Report by Credit Work Group Chair on ERCOT credit matters	M. Davies	8:30 a.m.
7.	Credit Work Group Chair/Vice Chair (Vote)	C. Yager	8:35 a.m.
8.	Review proposed RFP for third party credit review	C. Yager	8:40 a.m.
9.	Review results of annual audit (Vote to accept independent auditor's report)	M. Petterson	8:50 a.m.
10.	Debt financing and liability management (Vote)	C. Yager	9:10 a.m.
11.	Preview proposed Texas Regional Entity 2008 budget and timeline	L. Grimm	9:30 a.m.
12.	Quarterly investment performance update	C. Yager	9:45 a.m.
13.	Committee briefs (Q & A only)	All	9:50 a.m.
14.	Future agenda items	S. Byone	9:55 a.m.
	Adjourn		10:00 a.m.

*Background material is enclosed or will be distributed prior to the meeting.*

*\* All times shown in the agenda are approximate.*

*The next Finance & Audit Committee Meeting will be held Wednesday, May 16, 2007 at ERCOT, 7620 Metro Center Drive, Austin, Texas 78744, in Room 206.*

**Draft MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING**

Austin Met Center

7:30 A.M.

**March 21, 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 **March 21, 2007**. The Meeting was called to order by **Miguel Espinosa** who ascertained that a quorum was present.

**Meeting Attendance**

**Committee members:**

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Not Present
Miguel Espinosa, Acting Chair	Unaffiliated Board Member	Unaffiliated Board Member	Present
Nick Fehrenbach	City of Dallas	Consumer	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

**ERCOT staff and guests present:**

Barry, Sean	PricewaterhouseCoopers (PwC) via telephone
Campbell, Cassandra	ERCOT
Day, Betty	ERCOT
Fournier, Marguerite	Competitive Assets
Maslon, Sharon	ERCOT
McElfresh, Brandon	ERCOT
Moon, John	John Moon Consulting
Moseley, Cheryl	ERCOT
Petterson, Mike	ERCOT
Simpson, Lori	Constellation
Solari, Mike	ERCOT
Thomas, Robert	Green Mountain
Troxell, David	ERCOT
Twiggs, Thane Thomas	Direct Energy
Vincent, Susan	ERCOT
Yager, Cheryl	ERCOT
Westbrook, Susan	ERCOT
Wullenjohn, William	ERCOT

**Executive Session**

At 8:30 AM, the Committee meeting was adjourned and the Committee went into Executive Session until approximately 9:06 AM, when the Committee returned to Open Session.

### **Approval of Previous Minutes**

**Nick Fehrenbach moved to approve the minutes for the previous meeting held on February 21, 2006, with the addition of William Wullenjohn as an attendee. Dan Wilkerson seconded the motion. The motion passed unanimously.**

The Committee discussed the minutes from the Credit Workshop held on March 5, 2007. Mr. Gahn and other members discussed a portion of the Workshop that they didn't believe was adequately addressed in the draft minutes; so, the Committee members agreed to provide comments to ERCOT staff and approve minutes from the Workshop at the April Committee meeting.

### **Review Finance and Audit Committee Charter**

Susan Vincent briefly reviewed and asked the Committee for their comments and concerns regarding the proposed modifications to the Finance & Audit Committee Charter which were included in the materials. The members extensively discussed the proposed changes, with particular emphasis on (a) the wording of the sections discussing credit risk and (b) the need to ensure that the charter does not incorporate specific goals that may be inconsistent with the Committee's overall responsibility. The Committee agreed that the Committee had oversight responsibility for the financial stability of the ERCOT market, but wanted time to further consider and discuss the amount of specificity that should be included in the Charter language. The Committee agreed to make additional redlined suggestions to ERCOT staff, discuss the Charter again at the April meeting, and vote to recommend proposed changes to the Charter to the Board by the May meeting.

Mr. Fehrenbach then noted that the Charter tasks the Committee with responsibility for resolving differences between ERCOT's management and the independent auditor and questioned whether the Committee has the authority to compel action by ERCOT management. Ms. Vincent noted that this charter requirement is consistent with the mandates of the Sarbanes-Oxley Act. Sean Barry noted that under both Sarbanes-Oxley and GAAP, the Committee would be considered responsible for such resolutions. Mr. Espinosa pointed out that ERCOT's Board of Directors must approve the Committee Charter, and that such approval would be a de facto grant of authority.

### **Review Credit Workgroup Charter**

Cheryl Yager briefly highlighted the Committee's March 5<sup>th</sup> Credit Workshop. The Committee extensively discussed the issues raised in the workshop and further discussed the independent third party assessment of ERCOT's credit risk that the Committee had directed ERCOT staff to seek. Scott Gahn requested that ERCOT staff work with the Credit Workgroup to build scenarios for catastrophic credit events, so that the ramifications of such events could be analyzed. He emphasized he would like for the third party to specifically include a consideration of the extent to which market forces would mitigate the perceived credit risk. Ms. Yager agreed that staff would obtain input from the Credit Workgroup to assist staff in drafting additional scenarios to be addressed by the third party. The Committee determined that the members needed more time to make comments to and discuss the Credit Workgroup Charter and moved further discussion of the Charter to the April Committee meeting.

### **Update on Liquidity and Liability Management**

Ms. Yager informed the Committee that ERCOT was monitoring interest rates and was preparing financing recommendations for consideration at the April Board meeting. She noted

that the dollar amount of the financing request would depend upon actual expenditures for nodal implementation by early April.

### **Financial Audit Update**

Mike Petterson informed the Committee that the financial audit field work commenced on March 5, 2007, and that PricewaterhouseCoopers (“PwC”) staff had not found any significant unusual findings, thus far. However, Mr. Petterson noted that, while working through the year-end accruals and impaired hardware for 2006, they had found possible impaired software for 2006, the amount of which was still being investigated. He also informed the Committee that management had also identified a potential post-retirement healthcare benefit obligation that had not previously been recognized. Mr. Petterson explained that actuarial assessment of potential liability is underway and is expected to be completed by the end of March, so he would update the Committee in April. Mr. Petterson noted that if determined to be material, this obligation could impact finalization of the 2006 audit report, and possible accounting treatment included: (a) financial statement footnote disclosure only; (b) adjusting entries recorded in 2006; or (c) restatement of 2005 financial statements and adjusting entries recorded in 2006. Sean Barry confirmed Mr. Petterson’s analysis and noted that the most significant impact would be felt if a restatement of 2005 were required. The Committee requested that it be kept apprised.

### **Preliminary 2008 Planning Assumptions**

Mr. Petterson reviewed several preliminary 2008 planning assumptions with the Committee. He noted that certain developments since late-2006 represented potentially higher effort (and higher cost) within ERCOT, including potentially higher operations and maintenance costs post Nodal go-live, which could translate into upward pressure on the System Administration Fee. The items to consider include (a) staffing adjustments due to transition to a Nodal market and the hiring of a new CEO; (b) facilities considerations, such as possible Austin office/control center issues (including security, reconfiguration and possible relocation) and potential expansion or reconfiguration of Taylor office space; (c) Texas Regional Entity organization and responsibilities; and (d) Independent Market Monitor support. Mr. Gahn asked if this meant that there might be a need to increase the System Administration Fee, and Mr. Petterson confirmed that this could be a consideration, but full details would be developed and discussed over the next few months.

### **Adjournment**

At 10 A.M., the meeting was adjourned. The next Committee meeting will be held on the morning of Wed. April 18, 2007.

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Susan Vincent, Secretary



**THE ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.  
FINANCE & AUDIT COMMITTEE CHARTER**

**Purpose**

The Finance and Audit committee of the Board of Directors of ERCOT shall:

1. Oversee the Company's budget process and adherence to budget;
2. Provide recommendations to the Board of Directors for establishing levels of financing and in setting the Company's fees, including its administrative fee;
3. Review and make recommendations to the Board of Directors regarding credit standards, procedures, governance, ERCOT Protocols and other market rules which impact credit risk, with the goal of maintaining the financial stability of the ERCOT market and minimizing credit losses, consistent with prudent credit practices;
4. Ensure that the Company's financial statements are timely audited by qualified accountants who are independent;
5. Assist the Board of Directors in fulfilling its oversight responsibility with respect to the Company's maintenance of an effective internal audit function;
6. Establish and maintain procedures for the receipt (including anonymous submission), retention and treatment of complaints regarding accounting, internal controls, and auditing;
7. Perform such other duties and responsibilities enumerated in and consistent with this Charter.

The Committee's function is one of oversight, recognizing that the Company's management is responsible for preparing the Company's financial statements, and the independent auditor is responsible for auditing those statements. In adopting this Charter, the Board of Directors acknowledges that the Committee members are not employees of the Company and are not providing any expert or special assurance as to the Company's financial statements or any professional certification as to the external auditor's work or auditing standards. Each member of the Committee shall be entitled to rely on the integrity of staff and external auditors to provide accurate, complete financial and other information to the Committee, absent actual knowledge to the contrary.

While the Committee has the responsibilities, duties and powers set forth in this Charter, it shall be the responsibility and duty of the Company's management and independent auditor, and not the responsibility or duty of the Committee, to plan or conduct audits, to make any determination that the Company's financial statements are complete, accurate and in accordance with generally accepted accounting principles, and to assure compliance with laws, regulations and the Company's ethics policies. It is the responsibility of the Committee to conduct investigations, and resolve disagreements regarding financial reporting, if any, between management and the independent auditor.

The Committee shall provide assistance to the Board in fulfilling its oversight responsibility relating to the Company's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the annual independent audit of the Company's financial statements and the legal compliance and ethics programs as established by management and the Board. In so doing, it is the responsibility of the Committee to maintain free and open communication between the Committee and the Company's independent auditors, internal accounting personnel and management.

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**Membership**

The Finance and Audit Committee of the Board of Directors of ERCOT (the "Committee") shall be comprised of at least five Board members, at least three of which are from market Segments and two or more of which must be Independent Board members of ERCOT (the "Company"). Each Member must be able to read and understand fundamental financial statements, including the balance sheet, income statement and cash flow statement. At least one Member must have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background which ensures the individual's financial sophistication, including a past or current position as a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

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The board members shall decide from among themselves who shall participate in the Committee. The term shall be for one year.

The Chair of the Committee shall be selected through a majority vote of the Committee members. The Committee Chair shall not be the Chief Executive Officer of the Company and shall have accounting or related financial management expertise.

The Committee may request that any officers or employees of ERCOT, or any other person, whose advice and counsel are sought by the Committee, attend any meeting of the Committee to provide such pertinent information as the Committee requests.

**Board members (other than Committee members) including Board member alternates may attend and participate in all Committee meetings but may not participate in Committee voting.**

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Non-Committee members may attend Committee meetings at the discretion of the Committee. The Committee may exclude any persons who are not Directors, the Segment Alternate or the Director's Designated Representative from any meeting or portion of any Committee meeting that the Committee determines, in its discretion, needs to be held in closed session to discuss personnel issues, confidential legal matters, negotiations or other business of the Committee involving confidential information.

**Qualifications**

Each member of the Committee shall also meet any experience requirements as may be established from time to time by the Board of Directors. The Board of Directors shall endeavor to appoint at least one member to the committee who is a financial expert as such term may be defined from time to time by the Board of Directors, the accounting industry or other regulatory authorities.

**Authority**

In discharging its oversight role, the Committee is empowered to investigate any matter brought to its attention with full access to all books, records, facilities and personnel of the Company and the power to retain outside counsel or other experts for this purpose. All employees are directed to cooperate as requested by the Committee or any of its Members for Committee purposes. The Committee may request any officer or employee of the Company, the Company's outside counsel or the Company's independent auditor to attend a meeting of the Committee or to meet with any Member or any consultants to the Committee.

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The Company's senior internal auditor shall report directly to the Committee. For administrative purposes, the senior internal auditor shall report to the CEO. The Committee shall approve an Annual Audit Plan prepared by the senior internal auditor. The senior internal auditor shall (1) manage the execution of the Annual Audit Plan, (2) conduct investigations at the direction of the Chair and the Committee, and (3) make periodic reports to the Committee at regularly scheduled Committee meetings and as otherwise directed by the Chair and the Committee.

The Committee may appoint workgroups or task forces to investigate issues defined by the Committee. Members of such workgroups or task forces need not be Directors. Such workgroups or task forces shall have no authority to bind the Committee or the Company.

### **Structure**

~~The presence of at least half of the~~ members of the Committee shall constitute a quorum. At any meeting at which a quorum exists, the act of a majority of the members present at a meeting shall be the act of the Committee. For the purposes of voting, members who recuse themselves from voting on an issue shall not be counted as present for that vote.

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The Chair, in consultation with the Chief Financial Officer, shall develop the agenda, the frequency, and length of meetings and shall have unlimited access to management and information for purposes of carrying out functions of the Committee. The Chair shall establish such other rules, as may from time to time be necessary and proper for the conduct of the Committee.

### **Duties and Responsibilities**

The following shall be the prominent recurring duties and responsibilities of the Committee in carrying out its oversight functions. The duties and responsibilities are set forth below as a guide to the Committee with the understanding that the Committee may alter or supplement them as appropriate under the circumstances to the extent permitted by applicable law, and by the Company's Articles of Incorporation and Bylaws:

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#### ***With respect to budget oversight and financing:***

1. Annually, on a schedule to be established by the Board of Directors, the Committee shall review staff's proposed budget for the following year, including proposed staffing levels, proposed capital expenditures, and other proposed expenditures.
2. The Committee shall review the staff's estimate of revenues to support all proposed expenditures, including staff's recommendations for fee levels for the following year.
3. The Committee shall review the staff's recommendation of the amount and type of financing that may be needed to support the proposed budget, including the staff's proposed financial performance measures (e.g. ratios).
4. Following the Committee's review of the above items, the Committee shall recommend to the Board of Directors a staffing level, a proposed budget, proposed fees, and proposed financial performance measures for the following year.

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With respect to maintaining the financial stability of the ERCOT market and minimizing credit losses, consistent with prudent credit practices, the Committee shall make recommendations to the Board of Directors regarding:

- The adoption and maintenance of a credit standard that defines the goals for the market with respect to financial stability;
- The adoption and maintenance of credit procedures that provide an appropriate system of checks and balances to help ensure compliance with ERCOT's credit standard, credit procedures, and credit-related Protocols and market rules;
- The establishment of creditworthiness requirements, methods of evaluating credit exposure and credit risk mitigation strategies which adequately address financial stability goals;
- Credit implications of all proposed changes to market rules;
- Other recommended steps for maintaining financial stability of the ERCOT market.

**With respect to the independent auditors:**

- Annually, the Committee shall recommend to the Board of Directors the selection and engagement of the Company's independent auditor. The Committee shall fulfill the oversight responsibility of the Board of Directors with respect to the independent auditors' audit of the books and accounts of the Company and for the fiscal year for which it is appointed.
- The Committee shall approve the provision of all auditing and non-audit services (in excess of \$5,000) by the independent auditor to the Company in advance of the provision of those services and shall also approve the fees for all non-audit services provided by the independent auditor.
- Provision of non-audit services of less than or equal to \$5,000 by the independent auditor to the Company do not require pre-approval from the Committee, but shall be communicated in writing to the members of the Committee at the first meeting following the engagement for the non-audit services at issue.
- In connection with the Committee's approval of non-audit services, the Committee shall consider whether the independent auditor's performance of any non-audit services is compatible with the external auditor's independence.
- At least annually, the Committee shall obtain and review a report by the independent auditor describing:
  - the independent auditor's internal quality control procedures;
  - all relationships between the independent auditor and the Company, in order to assess the auditor's independence
- The Committee shall also review any report by the independent auditor describing:
  - significant accounting policies and practices used by the Company;
  - alternative treatments of financial information as required to be discussed by the independent auditors with the Committee; and
  - any other material written communication between the independent auditors firm and the Company's management.
- Establish the Company's hiring policies for employees who are former employees of the Company's independent auditors

**With respect to the Company's financial statements:**

- The Committee shall discuss the annual audited financial statements with management and the independent auditor, including the Company's disclosures.
- The Committee shall review disclosures made to the Committee by the Company's CEO and CFO about any significant deficiencies in the design or operation of the internal

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controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.

3. In connection with its review of the Company's financial statements, the Committee shall review and discuss with the independent auditor the matters relating to the conduct of the audit as they may be modified or supplemented, including, but not limited to, significant judgments, significant estimates, critical accounting policies, and unadjusted differences.
4. Review major changes to the Company's auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.
5. Review with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or published reports that raise material issues regarding the Company's financial statements or accounting policies.
6. Review with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.
7. Review any and all press stories that relate to the Company's accounting and disclosure, require that management or the auditor explain any negative comments and determine whether these comments necessitate a change in the accounting structure of the Company.
8. Based on its review and discussions with management, the internal auditors and the independent auditor, the Committee shall provide a recommendation to the Board of Directors whether the Company's financial statements should be accepted.

***With respect to periodic reviews and reports:***

1. Periodically, the committee shall meet separately with senior management, internal auditors and the independent auditors.
2. The Committee shall review with the independent auditor any audit problems or difficulties and management's response to them.
3. The Committee shall review the Company's policies with respect to risk assessment and risk management.
4. The Committee shall review a summary of the Company's dealings with any financial institutions that are also market participants.
5. The Committee shall communicate to the Board of Directors the matters discussed at each meeting of the Committee, including any issues with respect to the quality or integrity of the Company's financial statements, the performance and independence of the Company's independent auditors or the performance of the internal audit function.
6. The Committee shall discuss with the Board of Directors the matters discussed at each meeting of the Committee.
7. The Committee shall review and assess the adequacy of this Charter annually and recommend any proposed changes to the Board of Directors.

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***With respect to the other matters:***

1. The Committee shall inquire of management and the independent auditors about significant risks or exposures to the Company and the ERCOT market and assess the steps management has taken to minimize such risks.
2. The Committee shall establish procedures for:
  - a. The receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and

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- b. The confidential, anonymous submission by the Company's employees of concerns regarding accounting or auditing matters.
- 3. The Committee shall review, considering the recommendations of the independent auditors and the CFO, the scope and plan of the work to be done by the Company's internal auditor, and the results of such work.
- 4. The Committee shall establish the Company's hiring policies for employees who are former employees of the Company's independent auditor's.
- 5. The Committee shall review the appointment and replacement of the senior internal auditing executive, the scope of the internal audit plan and the significant reports to management prepared by the internal auditing department and management's responses.
- 6. The Committee shall meet at least biannually with the independent auditor, the chief financial officer and the senior internal auditing executive in separate executive sessions.

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**Meetings**

The Committee shall meet at least once during each fiscal quarter, and as many additional times as the Committee shall deem necessary or appropriate.

**Minutes**

The Committee shall designate a secretary, who may be a Committee Member of employee of ERCOT, who shall prepare or cause to be prepared the minutes of each meeting and file such minutes with the corporate records of the Company. The secretary shall send, or cause to be sent, copies of such minutes to each of the Members.

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**Evaluation**

The Committee shall undertake an annual evaluation assessing its performance and, in light of this, consider changes in its membership, charter or procedures. The Committee shall report to the Board the results of its evaluation, including recommended charter, membership and other changes, if any.

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or to assure compliance with laws and regulations or the Company's ethics policies.		
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**Draft** MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE

Credit Workshop  
Austin Met Center  
March 5, 2007

**Meeting Attendance:**

Board Members

William Taylor - Calpine  
Scott Gahn – Just Energy  
Clifton Karnei – Brazos Electric Coop  
Miguel Espinosa - Unaffiliated  
Bob Thomas – Green Mountain Energy  
Dan Wilkerson – Bryan Texas Utilities  
Nick Fehrenbach – City of Dallas  
Brad Cox – Tenaska Power Services (by phone)

Other Guests

Barry Smitherman – PUCT Commissioner  
Morgan Davies – Calpine, Chair of Credit Working Group (CWG)  
Keith Emery – Tenaska  
Robert Miller – CPS Energy  
Bruce Thompson – Airtricity  
Robert Alsbrooks – Tenaska  
Tamila Nikazm – Austin Energy  
Marguerite Wagner – Reliant  
Neal Frederick – PUCT Staff  
Darryl Tietsen – PUCT Staff

ERCOT Staff

Steve Byone  
Cheryl Yager  
Andrew Gallo  
Susan Vincent  
Chad Seely  
Vanessa Spells  
Srinu Sundhararajan  
Don Meek

Pursuant to notice duly given, the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened a Credit Workshop at 1:00 PM on March 5, 2007. Clifton Karnei, Chairman of the Board's Finance & Audit (F&A) Committee, invited Cheryl Yager to begin the meeting by reviewing the agenda. Ms. Yager began with the antitrust admonition.

**Credit Exposure and Credit Risk Factors**

Ms. Yager noted that credit events have occurred over the last several years (~ \$15 million in short-pays and uplifts from 2003 and ~ \$6 million from 2005-2006). She then discussed actions taken by ERCOT Staff and Market Participants to address outstanding credit issues. Ms. Yager stated that, as ERCOT staff understands them, the credit objectives are: (1) to provide financial stability for the market, (2) to ensure Market Participants understand the credit exposure that exists in the market and (3) to assess credit risks as they are identified.

## **Credit Risk Factors**

- Creditworthiness of QSEs representing Load
- Credit exposure

Ms. Yager noted that all credit risk factors should be viewed together as the Board considers the overall credit position of the market.

She then provided statistics regarding QSEs representing Load, including that 76% of QSEs do not meet the creditworthiness standards established by the ERCOT Board. Commissioner Smitherman asked for the creditworthiness standards and Ms. Yager provided a brief summary of those standards.

Ms. Yager indicated that, when considering the credit quality of the market as a whole, the Board should consider the effect of recent changes in the market place that might affect credit quality over the near term, including removal of the price to beat and an increase in the offer cap. She also indicated that the Board should consider trends to date in the overall credit quality of the Market Participants, noting that, overall, QSEs representing Load are generally weaker financially than the group as a whole five years ago.

Mr. Karnei pointed out that only eight of seventy QSEs directly meet the creditworthiness standards.

Commissioner Smitherman asked about the split between Market Participants that post cash versus Letters of Credit. Ms. Yager stated that she did not have that information with her, but noted that ERCOT's experience has been that both cash and Letters of Credit are fairly easily accessed in the event of a default.

In discussing past defaults, Mr. Gahn mentioned that many of the market rules have changed since the 2003-2005 timeframe. Ms. Yager agreed that had the same events occurred today, the defaults would likely have resulted in less loss to the market.

However, Ms. Yager pointed out that, even after the changes to the market rules, significant exposure can occur before ERCOT can identify the problem (e.g. from unexpected market shocks -- curtailments, weather events, etc. -- or from individual Market Participant behavior). Additionally, Balancing Energy Service (BES) prices are significantly impacted by the amount of MWhs taken from BES and can fluctuate dramatically and unexpectedly.

Ms. Yager raised the question of whether the market rules and credit mitigation strategies should address only "normal" credit issues or whether they should prepare for "shock" events.

Ms. Yager then presented an example of a Market Participant default for a relatively large entity, yielding a short pay and uplift of ~ \$78 million.

Mr. Taylor pointed out that the example assumes a large number of Market Participants defaulting at the same time or a very large Market Participant default. Ms. Yager agreed, but pointed out that this slide was intended to show the impact of a big event, not necessarily its probability.

Additionally, Ms. Yager pointed out that ERCOT calculates collateral based on historical usage which, in most Mass Transition situations, will not cover all of the future exposure. ERCOT also cannot limit MWh use of BES; *i.e.* if a QSE loses a bi-lateral contract, its Load is served entirely through BES and ERCOT cannot shut off the flow of electricity in the near term.

Ms. Yager then presented a slide demonstrating the improvement of the market rules to address Mass Transition situations over the last few years, pointing out, however, that a “gap” in credit still exists (albeit a smaller gap than in the past).

Ms. Yager then discussed differences between how the various Independent System Operators address defaulting entities and provided an example of a short-pay and uplift event.

### **Legal/Policy Directives Re: Financial Stability in the ERCOT Region**

Andrew Gallo then addressed Legal and Policy considerations associated with credit issues.

Mr. Karnei pointed out that the PUCT rules (§25.503) contain a reference to credit issues and indicate that the PUC has delegated this responsibility to ERCOT. Mr. Gallo agreed, but questioned whether the reference to “ERCOT” in that rule means “ERCOT Staff” or “ERCOT Market Participants.” Mr. Karnei opined that these provisions mean ERCOT, Inc.

Mr. Gahn commented that these provisions do not necessarily mean ERCOT, Inc. and raised a question regarding whether the rule means the ERCOT Board, ERCOT Market Participants or ERCOT, Inc.?

Commissioner Smitherman gave an example of the perfect storm in which the governor called the PUCT after a significant credit event and the PUCT indicated that it delegated credit issues to ERCOT and ERCOT Staff would then indicate that they tried to get Market Participants to tighten credit standards, but the Market Participants did not cooperate.

Mr. Gahn commented that it is possible that ERCOT could weaken the market by holding collateral because a company would not be able to use those funds in the bi-lateral market.

Ms. Yager commented that we need to first decide whether, from a credit standpoint, we are where we want to be and if not, what the target is. Then we can discuss how to get there. If further mitigation is needed, the best answer is to take risk out of the market, but other risk mitigation strategies can be considered other than merely increasing collateral requirements. Mr. Gahn commented that he struggles with these issues and whether collateral is the best solution to help protect the market.

Mr. Taylor commented that ultimately it will be the PUC or the Legislature that will force action if there is a situation.

### **Credit Environment**

Morgan Davies, Chairman of the CWG, made a presentation regarding the credit environment in the market.

Mr. Davies highlighted the potentially conflicting goals for the market and individual Market Participants. He then reviewed the processes currently in place to help ensure the financial stability of the market. He pointed out that: (1) ERCOT uses the stakeholder process to address credit issues and (2) the F&A Committee Charter calls for the Committee to review credit topics and ERCOT’s credit policies and make recommendations to the Board regarding those policies. To fulfill this requirement, the Committee relies, in part, on the CWG. He also highlighted changes proposed to the CWG Charter governing the CWG and talked about best practices as defined by the Committee of Chief Risk Officers.

Mr. Espinosa asked whether, in Mr. Davies' opinion, the Technical Advisory Committee (TAC) has sufficiently requested CWG input on credit-related matters. Mr. Davies stated that he believes in many cases, TAC leadership has done so. He also stated that CWG addresses credit issues even when not invited to do so by TAC. Ms. Yager stated that the best credit-related solutions have been developed when TAC or its subcommittees and the CWG work together. Mr. Davies provided an example of how the CWG is working with the Commercial Operations Subcommittee (COPS) on a proposal before COPS to move from daily payment of invoices to weekly payment of invoices in nodal market design.

Mr. Gahn asked about the point in time when the CWG gets involved in the Protocol Revision Request (PRR) process. Ms. Yager stated that CWG provides input to all PRRs as they go to the Protocol Revision Subcommittee (PRS) and will, if asked, provide input earlier in the process. Mr. Gahn asked whether CWG is usually asked to participate early in the process. Ms. Yager indicated that CWG is brought in early in the process some of the time. Sometimes, however, the first time CWG is aware of an issue is when a PRR is moving through PRS.

#### How to Determine an Acceptable Amount of Risk

Ms. Yager then presented information on steps taken in recent years to address credit issues. She mentioned that the F&A committee asked the CWG to address residual credit issues after the PRRs were passed to shorten the Mass Transition timeline. The CWG proposed PRR683 which, ultimately, the PRS rejected. Ms. Yager then reviewed the advantages and disadvantages in the stakeholder process dealing with credit-related issues.

In conclusion, she asked how the Board members and F&A Committee would like to measure/consider credit risk. Did F&A want to: (1) confirm the Market Participants' assessment, (2) seek an independent assessment, (3) compare the current situation to "zero" risk, or (4) do something else?

Mr. Karnei stated that he favors having an independent entity assess the current situation and provide recommendations. Mr. Gahn agreed to that approach, but asked who would conduct such a study. Ms. Yager stated that someone like Standard & Poor's or Moody's could do it, but ERCOT would use a Request For Proposal process.

Mr. Gahn stated that he would prefer that an independent entity provide recommendations and let the Board decide what to do.

He then stated that he has several remaining questions:

- (1) What, if anything, triggers the Board to intervene when Market Participant committees reject further action such as was the case with PRR683?
- (2) What process should the Board use when or if a decision is reached to intervene related to credit issues (is a PRR the only way)?
- (3) How much of this issue is setting credit "policy" and does ERCOT ultimately have the obligation to establish credit "policy" or should the Market Participants request a decision from the PUCT?

Mr. Karnei stated that the F&A Committee reviews credit statistics and topics every month. Additionally, a group of credit professionals (the CWG) made a recommendation (PRR683) and it failed. This indicates that, sometimes, Market Participants may not follow the F&A Committee's recommendations regarding credit issues. Therefore, he suggested that action



may need to be taken directly by the Board. Mr. Taylor expressed concern for any action that may by-pass the stakeholder processes. Ms. Yager noted that the process could begin with a new PRR and, if it fails, it could be appealed to the TAC in the normal course and, if necessary, be appealed to the Board.

Mr. Karnei stated that the Board has a fiduciary duty that the members of PRS do not have. Mr. Taylor stated that, in his opinion, we should cease focusing on PRR683. He believes that credit decisions must have an opportunity to be addressed through the TAC.

Mr. Fehrenbach stated, in his opinion, any changes to the credit policies should go through the stakeholder process. However, if that does not lead to a resolution with which the Board agrees, the Board is not required to follow the stakeholders' recommendation.

Mr. Karnei asked Mr. Byone the earliest date on which an independent assessment could be presented to the Board. Mr. Byone stated that he believes April is the earliest, but we would first need to define the scope of work for the analysis.

Mr. Davies stated that there are two ways to deal with risk: (1) mitigate it (e.g. compressing the Mass Transition timeline) and (2) transfer it (e.g. insurance; derivatives). He stated that derivatives tend to focus on investment grade entities and most ERCOT Market Participants are not investment grade. He also stated that the CWG is looking at ERCOT's credit standards right now.

Mr. Wilkerson stated that there is a perception difference because there are not too many industries in which someone must assess the financial risk he faces of having a *peer* default. Mr. Espinosa pointed out that it was also uncommon for most entities to be able to set the collateral requirements for themselves. Mr. Gahn pointed out that, in the stakeholder process, voting is equally distributed but credit risk is not.

Mr. Fehrenbach stated that the F&A Committee should ensure that ERCOT follows industry best practices regarding risk mitigation. If we are, he believes ERCOT would receive some benefit of the doubt if a "perfect storm" credit event occurred. Mr. Davies stated that the Committee of Chief Risk Officers has a database of "best practices" to which the committee could refer.

Mr. Byone recapped, by stating that he heard consensus among F&A members that the Board has oversight responsibility for financial stability in the ERCOT market. All agreed. He then noted that he heard agreement that the group believed it was appropriate that an independent assessment be undertaken to obtain further information relating to the level of credit exposure remaining in the market and possible alternatives to further address remaining credit risk. The Committee could then use such information to make a determination of next steps, if any.. The Committee concurred on this next step. Therefore, he recommended that ERCOT staff draft an RFP, including input from CWG for specific risk case scenarios, circulate it to F&A Committee members to confirm the scope of work and, ultimately, issue the RFP and present the responses to the F&A Committee for final consideration. The committee agreed with these steps.

Mr. Karnei thanked Commissioner Smitherman for attending and asked for any final thoughts from him. Commissioner Smitherman stated that he appreciated the robust dialogue today and believed the steps outlined would be helpful in the process.

Mr. Karnei then thanked everyone for attending and adjourned the meeting at 3:50 p.m.

**<Charter document follows>**



## Electric Reliability Council of Texas, Inc.

### ERCOT Credit Work Group Charter

#### I. Purpose and Authority

The Electric Reliability Council of Texas, Inc. (ERCOT) Board of Directors (**Board**) established the ERCOT Credit Work Group (CWG) as a group of credit professionals to help ensure that appropriate procedures are implemented to mitigate credit risk in the ERCOT Region in a manner that is fair and equitable to all **Market Participants**.<sup>1</sup>

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The CWG will review all sections of the ERCOT Protocols that impact creditworthiness requirements or collateral calculation and provide recommendations to the Finance and Audit Committee of the Board, with a copy to the Chair and Vice Chair of **the** TAC. **The** CWG will provide comments to **the** TAC subcommittees when **PRRs**, **NPRRs** or other actions have credit implications.

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#### II. Reporting Relationships

- The CWG reports to the Finance and Audit Committee of the Board.

#### III. ERCOT Credit Work Group Functions

The functions of the **CWG** include, but are not limited to:

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- Providing input to **PRRs and NPRRs** that impact credit **in accordance with this Charter and Board approved credit policies**
- Providing input to the **ERCOT** Creditworthiness Standards

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<sup>1</sup> Capitalized terms used in this document shall have the meanings ascribed to them in the ERCOT Protocols unless otherwise noted.

In addition, the CWG may, from time-to-time, make recommendations to existing or proposed systems, projects, plans, Protocols and policies and procedures of ERCOT impacting credit issues.

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The CWG shall not engage in any activities that conflict with or violate ERCOT Protocols or the ERCOT Ethics Agreement.

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The CWG shall at all times comply with the Antitrust Guidelines for Members of ERCOT Committees, Subcommittees and Working Groups.

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The CWG shall not have direct responsibility or authority over ERCOT Staff. Although the CWG will recommend courses of action, the responsibility for implementation of policies or procedures shall rest with ERCOT Staff.

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In carrying out its responsibilities, the CWG shall be guided by industry best practices.

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#### IV. Credit Work Group Administration

Each Corporate Member of ERCOT may designate one employee that meets the Qualifications Guidelines for Credit Work Group Membership as a voting member to participate in the activities and attend meetings of the CWG. The Consumer representatives on the ERCOT Board may each designate one person, that meets the Qualifications Guidelines for Credit Work Group Membership, as a voting member to participate in the activities and attend meetings of the CWG.

¶ The CWG will meet at least quarterly to review credit policy. In addition, they will meet as needed to address issues as they arise or Protocol revisions as they are proposed or needed. All meetings will be posted on the ERCOT website and are open for interested parties to attend and participate in discussions.¶

All designations of CWG members must be sent to ERCOT's Credit Manager.

¶ Each Market Participant may but is not required to have one designated voting member on the CWG. The Market Participant may appoint an alternate for the designated voting member. Any member of the CWG must meet the qualifications as identified on the attached Qualifications Guidelines for Credit Work Group Membership. The Finance and Audit Committee will review the requirements for membership in the CWG annually.¶

The Chair and Vice-Chair of the CWG shall be elected annually by the CWG membership and confirmed by vote of the Finance and Audit Committee.

¶ Each member of the Committee shall have one vote.¶

The CWG Chair shall report at least semi-annually to the Finance and Audit committee regarding the state of credit policy within the ERCOT Region. In addition, the CWG Chair shall notify the Finance and Audit Committee Chair of significant credit issues as they arise.

¶ While the CWG will provide a recommendation based on the majority view of the CWG to the appropriate committee, any dissenting party shall have the right to present its view to the same committee if they choose to do so. ¶

¶ All votes shall be made at the time of the meeting by a representative of the member's company or by proxy by another member. If the vote is going to be made by proxy, the member must ensure that the appropriate ERCOT staff has received the proxy by electronic w (... [1]

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In order to discharge its responsibilities, the CWG may form temporary or ad hoc task forces. The CWG Chair, with CWG approval, shall appoint the chair for each task force for a term of one year or the duration of the task force which ever is less. Each task force chair may serve in that role for no more than two consecutive one year terms. The CWG shall direct these task forces and make assignments as necessary.

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All task forces are responsible for reporting planned activities/projects and results to the CWG for review. All task force actions are subject to CWG review.

## **V. Meetings**

### **A. Quorum**

In order to take action, a quorum must be present. At least one CWG member from four of the seven market Segments listed below must be present at a meeting to constitute a quorum: Independent REPs (and Aggregators), Independent Generators, Independent Power Marketers, Municipals, Cooperatives, Investor Owned Utilities, and Consumers.

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Each CWG member or CWG member's company represented on CWG may designate, in writing, an Alternate Member or proxy who may attend meetings and vote on the member's behalf. Alternate Members must be employees of same company as the CWG member designating them or may be agents with a contractual obligation to represent the interest of the Company designating them. Proxies shall not be counted toward establishing a quorum at a CWG meeting. If a CWG member wishes to designate an Alternate Member or proxy, the CWG member must send to ERCOT notification of the designation of such Alternative Member or proxy in advance of any meeting and the designation shall be valid for the time period designated by the CWG Member.

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Comment [Credit1]: Nick, this may be a problem...CWG did not require that proxies be existing CWG members.

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### **B. Meeting Schedule and Notification**

The CWG shall meet at least quarterly to review credit policy. In addition, the CWG shall meet as needed to address issues as they arise such as PRRs or NPRRs as they are proposed or needed. Meeting notices and agendas shall be sent to the CWG distribution list and posted on the ERCOT website at least one (1) week prior to the CWG meeting unless an emergency condition requires shorter notice. Meeting notices for emergency meetings shall be sent to the distribution list and posted on the

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ERCOT website and shall clearly identify the condition requiring the shorter notice. Except in cases of emergency, all agenda items requiring a vote of CWG must be published at least one week prior to the meeting at which the vote will take place. In the case of an emergency, all agenda items requiring a vote of CWG shall be published as soon as possible prior to the meeting at which the vote will take place and the need for the emergency vote shall be clearly identified. All CWG meetings may be attended by any interested observer.

### **C. Voting**

**Votes:** At all meetings, each Segment shall have one (1) vote. CWG members present at the meeting and participating in the vote shall receive an equal fraction of its Segment's vote.

**Abstentions:** In the event that a CWG member abstains from a vote, the Segment vote shall be allocated equally among the members casting a vote.

**Voting:** In matters determined by the CWG Chair to require a vote of CWG or when any CWG member requests a vote on an issue, each CWG member shall have one (1) vote except that a CWG member holding a valid proxy for another member shall have one (1) vote plus one vote for each proxy held. A motion passes when (A) a majority of the aggregate of the fractional Segment votes are: (i) affirmative, and (ii) a minimum total of three (3) and (B) a minimum of 67% of voting individuals meet Qualification guidelines.

**Comment [NF2]:** Suggest proxy holders be qualified as CWG members. If not, suggest at least: (a) proxies be granted only to employees of the same company or in same market segment as CWG member granting the proxy OR (b) an individual may only vote in 1 segment, regardless of # of proxies held.

Any dissenting party shall have the right to present its position to the Finance and Audit Committee if such dissenting party chooses to do so.

**E-mail voting:** An e-mail vote is permitted provided a Notification is distributed to the CWG distribution list. An e-mail vote is subject to the same Notification requirements as other votes unless it is procedural only or has been designated as an urgent vote. A Notification must include a detailed description of the issue or proposition on which the vote will occur. A request for an e-mail vote shall be initiated only by the CWG Chair. A quorum of CWG members must participate in the e-mail vote. Participation requires casting a vote or abstaining. Votes shall be submitted to ERCOT for tallying by the close of two (2) Business Days after ERCOT staff circulates the Notification of the vote. Votes are tallied

in the same manner as a regular meeting. The final tally shall be distributed to the CWG distribution list and posted on the ERCOT MIS.

**D. Conduct of Meetings**

The CWG Chair, or Vice-Chair in the Chair's absence shall preside at all meetings and is responsible for preparation of agendas. In the absence of the CWG Chair or Vice-Chair, another CWG member shall preside at the meeting. The CWG members shall be guided by Robert's Rules of Order in the conduct of CWG meetings. ERCOT staff shall be responsible for recording minutes of CWG meetings and distributing and posting on the MIS the minutes and other communications to all CWG members and any other parties who express an interest in receiving such information. ERCOT staff shall endeavor to distribute and post the minutes of each meeting within seven days after the date on which the meeting took place. Generally, at the beginning of a CWG meeting, the minutes of the prior meeting shall be reviewed and approved by CWG.

CWG members and Alternate Members must meet the qualifications as identified on the attached Qualifications Guidelines for Credit Work Group Membership. The Finance and Audit Committee shall review the requirements for membership in the CWG annually.

This Charter shall be reviewed and ratified at least annually by the Finance and Audit Committee.

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**Additional Questions on the ERCOT Credit Work Group**

For additional questions on ERCOT's Credit Work Group and creditworthiness requirements, please contact the ERCOT Credit Manager, Vanessa Spells at (512) 225-7014 or by email at [vspells@ercot.com](mailto:vspells@ercot.com).

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## Qualification Guidelines for Credit Work Group Membership

Other than a Consumer CWG member, each CWG member must be an employee of a Corporate Member of ERCOT (as defined in the ERCOT By-Laws) in good standing. All CWG members and alternate members representing a Corporate Member must be actively engaged in or responsible for the credit activities of such Corporate Member.

All CWG members and alternate members must have experience in at least one or more of the following fields:

- Risk management (preferably credit risk management)
- Credit management and analysis
- Development and/or execution of credit risk policies and procedures
- Establishment and control of credit limits and terms
- Finance and/or loan administration
- Credit ratings analysis
- Commercial credit analysis
- Financial analysis

CWG members are encouraged to be active participants on the CWG.

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The Chairman of the CWG will be nominated annually by the membership of the CWG and confirmed by vote of the Finance and Audit Committee.

The CWG will meet at least quarterly to review credit policy. In addition, they will meet as needed to address issues as they arise or Protocol revisions as they are proposed or needed. All meetings will be posted on the ERCOT website and are open for interested parties to attend and participate in discussions.

Each Market Participant may but is not required to have one designated voting member on the CWG. The Market Participant may appoint an alternate for the designated voting member. Any member of the CWG must meet the qualifications as identified on the attached Qualifications Guidelines for Credit Work Group Membership. The Finance and Audit Committee will review the requirements for membership in the CWG annually.

Each member of the Committee shall have one vote.

While the CWG will provide a recommendation based on the majority view of the CWG to the appropriate committee, any dissenting party shall have the right to present its view to the same committee if they choose to do so.

All votes shall be made at the time of the meeting by a representative of the member's company or by proxy by another member. If the vote is going to be made by proxy, the member must ensure that the appropriate ERCOT staff has received the proxy by electronic written communication prior to the meeting.

The Chairman of the CWG will report at least semi-annually to the Finance and Audit committee as to the state of credit policy within ERCOT. In addition the Chairman of the CWG will notify the Chairman of the Finance and Audit Committee of significant issues as they arise.

- **The current status of the ERCOT Credit Policy was discussed at length at the Credit Workshop on March 5, 2007**
  - Any additional thoughts or questions?
- **Current projects**
  - Revisions to Creditworthiness Standards in process
  - Reviewed draft RFP Scope of Work for 3<sup>rd</sup> party assessment
  - Continue to review PRRs and NPRRs

- **CWG Charter requires that the CWG nominate and the F&A Committee confirm the CWG Chair**
  - Revisions to the CWG Charter add a Vice Chair position
- **The Credit Work Group have nominated individuals to fill both the CWG Chair and Vice Chair position**
  - Background on nominated individuals to be provided prior to the F&A Committee meeting
- **F&A discussion and vote to confirm Chair (and Vice Chair)**

Note – CWG intends to nominate a new Chair and Vice Chair in Nov/Dec 2007 (and future years) along the timeline under which other committees operate.

**<RFP Scope of Work document follows>**

## **Approach**

We will be concise in the RFP document. For entities that express an intent to bid (and who are qualified to bid...have appropriate expertise), we will provide specific scenario information to consider (if we need to before awarding the bid) and more detailed information about how the market functions.

ERCOT will use its standard form RFP. The Scope of Work and Deliverables is provided below for review.

## **RFP Scope of work**

ERCOT manages the credit function on behalf of the ERCOT market for ancillary services provided through ERCOT. Losses experienced as a result of defaults are borne directly by market participants, not by ERCOT. Market rules are defined in the ERCOT Protocols, the current version of which can be obtained at [www.ercot.com/mktrules/protocols/current.html](http://www.ercot.com/mktrules/protocols/current.html) . Two significant subsections include: (1) Section 9.4, which defines how the payment process works and (2) Section 16.2, which defines how QSEs are registered, including calculation of exposure and collateral requirements. The Creditworthiness Standards, which define when unsecured credit may be granted and acceptable forms of collateral, are set by the market and approved by the Board of Directors and are at [www.ercot.com/services/rq/qse/ERCOT\\_Final\\_Credit\\_Standards\\_9\\_2006.pdf](http://www.ercot.com/services/rq/qse/ERCOT_Final_Credit_Standards_9_2006.pdf) . The market is in the process of updating these Creditworthiness Standards.

In addition, ERCOT is currently implementing major changes to our market model as we move to a Nodal market design. These changes are currently scheduled to “go live” in December 2008. In the new market design, the ERCOT market will have a Day Ahead Market (which it does not currently have) and Congestion Revenue Rights that allow for obligations as well as options. The current version of the Nodal Protocols can be obtained on the internet at <http://nodal.ercot.com/protocols/index.html> .

ERCOT is seeking bids from qualified entities to

- 1) Review credit practices included in the ERCOT Protocols (both current and Proposed) and Creditworthiness Standards (both current and proposed) as well as ERCOT credit risk management practices generally and determine whether ERCOT’s practices are consistent with best practices of other markets (other ISO/RTO s and energy or financial exchanges, etc.) and energy or financial companies.

- 2) Develop a model based on best practices to be retained and used by ERCOT that will quantify potential exposure, both for expected and unexpected loss and will provide a related loss probability distribution over entire credit portfolio. The model should allow ERCOT to run multiple “what if” scenarios based on variable inputs that consider the factors outlined below. The model must be able to analyze risk consistent with Protocols and/or contract terms and by concentration (rating, size, etc.) as required. The model must be easily integrated into ERCOT’s credit management system.
- 3) Estimate the dollar impact and probability of potential negative credit events affecting the ERCOT portfolio (potential future exposure analysis) and provide a loss probability distribution using the model developed in 2) above.
- 4) Provide a capital adequacy assessment of the adequacy of the capital in the market (a) to absorb a maximum loss tolerable by the market, within a desired confidence interval, including specific stress scenarios and (b) to maintain a specific portfolio rating (should be able to provide assessment within the range BBB to AA).

Factors to be considered in the analyses include but are not limited to:

- 1) Credit quality of the portfolio of market participants currently in the market (e.g. default probabilities, ratings, rating migrations, etc). Deliverables should demonstrate impact of improvements and degradations in overall credit quality of the market. (ERCOT will be able to provide financial statement information. ERCOT does not currently formally score credits or obtain or calculate default probabilities).
- 2) In establishing credit quality or default probability for counter-parties for which ERCOT does not have financial statements, consider two different scenarios. First, assume the entity has the credit rating of a parent entity or consolidated group, as relevant. Second, assume the entity has a rating or default probability commensurate with a “B” rating.
- 3) BES price and price volatility – consider BES price and price volatility over the past 5 years (weighted average daily prices); consider the existing price cap for BES energy of \$1,000.00 and estimate the impact of higher price caps going into effect and historic and projected generation reserve margins.
- 4) Time required to removing an entity from the market, including notice periods and Mass Transition process timeline expected to be in effect by the third quarter of 2007.

- 5) Analysis should consider (a) current market rules under Protocols and guidelines as of April 1, 2007 and (b) key provisions of market rules under Nodal Protocols as of April, 2007.
- 6) Collateral held per Protocol requirements
- 7) Exclude very small QSEs (no generation and less than 200 MWh per day in load).
- 8) Analyses should be done at various confidence levels up to 99% confidence level
- 9) Analyses should use a 1 month, 3 month, 1 year and 3 year time horizon
- 10) Look at base case scenarios and “stress” scenarios.

#### Deliverables

- 1) Report providing information defined in scope of work
- 2) Documentation and data supporting analyses
- 3) Model defined in scope of work to be used by ERCOT going forward
- 4) Recommendations to mitigate credit exposure (including but not limited to ways to reduce risk, mitigate risk directly, spread risk more broadly within or outside of the market, etc)
- 5) Recommendations on improved methods to measure credit exposure and assign unsecured credit



- **Audit fieldwork and testing relating to ERCOT's 2006 financial statement audit has been completed**
- **A substantially complete draft audit report is attached**
  - No significant change to the financial numbers or associated footnotes are expected
  - No opinion letter is included; however, an unqualified opinion is expected
- **The final draft audit report will be distributed in advance of the April 18, 2007 meeting of the Finance & Audit Committee**

# **Electric Reliability Council of Texas, Inc.**

**Financial Statements  
December 31, 2006 and 2005**

**Last Edit - 4/10/2007 8:54 AM**

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**Electric Reliability Council of Texas, Inc.**  
**Index**  
**December 31, 2006 and 2005**

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**Electric Reliability Council of Texas, Inc.**  
**Statements of Financial Position**  
**December 31, 2006 and 2005**

<i>(in thousands of dollars)</i>	2006	2005
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 70,479	\$ 85,272
Accounts receivable	6,053	6,625
Unbilled revenue	5,879	7,111
Restricted cash	58,048	96,676
Prepaid expenses and other current assets	8,239	3,942
Total current assets	<u>148,698</u>	<u>199,626</u>
Property and equipment, net	126,681	130,414
Systems under development	37,573	9,605
Deferred regulatory assets	7,735	-
Interest rate swap	214	78
Debt issuance costs	1,143	1,330
Total assets	<u>\$ 322,044</u>	<u>\$ 341,053</u>
<b>Liabilities and Unrestricted Net Deficit</b>		
Current liabilities		
Accounts payable	10,356	3,070
Accrued liabilities	16,035	15,443
Market settlement liabilities	71,270	84,379
Security deposits	58,048	96,676
Notes payable, current portion	73,137	26,137
Total current liabilities	<u>228,846</u>	<u>225,705</u>
Notes payable	107,952	134,089
Other long term liabilities	188	408
Total liabilities	<u>336,986</u>	<u>360,202</u>
Commitments and contingencies (Notes 6 and 9)		
Unrestricted net deficit	<u>(14,942)</u>	<u>(19,149)</u>
Total liabilities and unrestricted net deficit	<u>\$ 322,044</u>	<u>\$ 341,053</u>

The accompanying notes are an integral part of these financial statements.

**Electric Reliability Council of Texas, Inc.**  
**Statements of Activities and Net Deficit**  
**Years Ended December 31, 2006 and 2005**

<i>(in thousands of dollars)</i>	2006	2005
Operating revenues		
Transaction fees	\$ 127,357	\$ 125,488
Membership fees and other	3,266	2,378
Total operating revenues	<u>130,623</u>	<u>127,866</u>
Operating expenses		
Salaries and related benefits	47,206	49,405
Depreciation	42,168	49,005
Facility and equipment costs	8,032	7,757
Consulting and legal services	10,433	9,321
Administrative and other	7,917	7,081
Hardware and software maintenance and licensing	7,740	7,189
Total operating expenses	<u>123,496</u>	<u>129,758</u>
Income (loss) from operations	7,127	(1,892)
Other income (expense)		
Interest income	2,200	1,494
Interest expense	(7,632)	(9,189)
Change in valuation of interest rate swap	136	78
Non-operating income	2,376	9
Change in unrestricted net deficit	4,207	(9,500)
Unrestricted net deficit, beginning of year	(19,149)	(9,649)
Unrestricted net deficit, end of year	<u>\$ (14,942)</u>	<u>\$ (19,149)</u>

The accompanying notes are an integral part of these financial statements.

**Electric Reliability Council of Texas, Inc.**  
**Statements of Cash Flows**  
**Years Ended December 31, 2006 and 2005**

<i>(in thousands of dollars)</i>	2006	2005
<b>Cash flows from operating activities</b>		
Change in unrestricted net deficit	\$ 4,207	\$ (9,500)
Adjustments to reconcile change in unrestricted net deficit to net cash provided by operating activities:		
Depreciation	42,168	49,005
Amortization of debt issuance costs	189	210
Change in valuation of interest rate swap	(136)	-
Net losses on disposition or impairment of capital assets	1,747	164
Changes in operating assets and liabilities:		
Accounts receivable	573	263
Unbilled revenue	1,232	143
Prepaid expenses and other assets	(4,298)	479
Other long-term liabilities	(220)	408
Regulatory assets	(7,735)	-
Accounts payable	7,525	(2,201)
Accrued liabilities	352	5,588
Net cash provided by operating activities	<u>45,604</u>	<u>44,559</u>
<b>Cash flows from investing activities</b>		
Capital expenditures for property and equipment and systems under development	(68,190)	(25,280)
Proceeds from sale of property and equipment	40	15
Net cash used in investing activities	<u>(68,150)</u>	<u>(25,265)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of short-term notes payable	47,000	-
Repayment of notes payable	(26,137)	(68,137)
Proceeds from issuance of long-term notes payable	-	50,000
Payment of debt issuance costs	(2)	(24)
(Increase) decrease in restricted cash	38,628	(74,277)
Increase (decrease) in market settlement liabilities	(13,108)	50,698
Increase (decrease) in security deposits	(38,628)	74,231
Net cash provided by financing activities	<u>7,753</u>	<u>32,491</u>
Net increase (decrease) in cash and cash equivalents	(14,793)	51,785
Cash and cash equivalents, beginning of year	85,272	33,487
Cash and cash equivalents, end of year	<u>\$ 70,479</u>	<u>\$ 85,272</u>
<b>Supplemental information</b>		
Cash paid for interest	\$ 8,755	\$ 9,435
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Accrued capital expenditures	\$ 2,454	\$ 2,453
Capitalized interest	\$ 1,293	\$ 591

The accompanying notes are an integral part of these financial statements.

# Electric Reliability Council of Texas, Inc.

## Notes to Financial Statements

### December 31, 2006 and 2005

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*(in thousands of dollars)*

#### 1. Organization and Operations

The Electric Reliability Council of Texas, Inc. (ERCOT) is an independent, not-for-profit corporation. ERCOT is one of 10 electric reliability regions in North America operating under the reliability and safety standards set by the North American Electric Reliability Corporation (NERC). Since July 31, 2001, ERCOT has also functioned as the independent system operator for its reliability region which comprises about 85% of the electrical load in Texas. The ERCOT region has an overall generating capacity of approximately 70,000 Megawatts.

The Public Utility Commission of Texas (PUCT) has primary jurisdictional authority over ERCOT which is responsible for ensuring the adequacy and reliability of electricity across the state's main interconnected power grid and for operating and settling the electricity markets it administers. ERCOT's market rules and operations are carried out in accordance with its Protocols filed with the PUCT. The ERCOT electric service region is contained completely within the borders of Texas, and it has only a few ties across state lines to import or export power with neighboring reliability regions. As a result, ERCOT is considered "intrastate" and not under the jurisdiction of the Federal Energy Regulatory Commission except for reliability oversight.

ERCOT is governed by a Board of Directors composed of 16 members. One board member is selected from each of the following market participant groups: independent retail electric providers, independent generators, independent power marketers, investor-owned utilities, municipal-owned utilities, and electric cooperatives. The remaining ten seats on the Board are filled by three consumer representatives, five unaffiliated Board members, the Chair of the Public Utility Commission of Texas, and ERCOT's Chief Executive Officer.

#### 2. Summary of Significant Accounting Policies

##### **Method of Accounting**

The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

##### **Unrestricted Net Assets (Deficit)**

Unrestricted net assets are those that are not subject to restrictions or stipulations and that may be expendable for any purpose in performing ERCOT's objectives. Accordingly, net assets of ERCOT and changes therein are classified and reported as unrestricted net assets (deficit).

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities of the financial statements and reported amounts of revenues, expenses, and capital expenditures during the reporting period. Actual results could differ from those estimates.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

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*(in thousands of dollars)*

**Cash and Cash Equivalents**

Cash and cash equivalents consist of deposits in banks, money market investment accounts, overnight deposits in government-backed securities and other highly liquid investments with an original maturity date of 90 days or less. Deposits may exceed the Federal Deposit Insurance Corporation's insured limit of \$100 for each account. ERCOT has not experienced any losses on its deposits of cash and cash equivalents.

**Restricted Cash**

Restricted cash represents amounts received for security deposits from ERCOT's market participants and funds held pending authorization from the bankruptcy court (Texas).

**Accounts Receivable and Revenue Recognition**

ERCOT funds its operations primarily through transaction fees collected from electric service providers operating within the Texas grid. Pursuant to the ERCOT protocols, the transaction fees are based on actual volume consumption and are approved by both ERCOT board of directors and the PUCT. This fee was 41.71 cents per megawatt hour in 2006 and 42 cents per megawatt hour in 2005. In 2006, ERCOT began collecting an additional rate of 6.63 cents per megawatt hour in connection with the market transformation project described in Note 8. Revenue from the transaction fees is recognized in the period that the underlying energy transaction occurs. Amounts not yet billed are accrued and presented as unbilled revenue on the statement of financial position.

ERCOT's other revenue relates to services offered to its participants including non-ERCOT load serving entity fees, connectivity to ERCOT's network, wide-area network usage, and membership dues. Revenue related to these services is recognized either as the services are performed or at the completion of the project, assuming ERCOT has no significant continuing obligation and collection is reasonably assured. The Company does not maintain an allowance for doubtful accounts as it does not believe it has a material risk of loss associated with lack of collection. Membership dues are recognized over the membership period.

**Property and Equipment**

Property and equipment consists primarily of computer equipment and buildings for operations, and are recorded at cost. Depreciation is computed on the straight-line method using the half year convention over the estimated life of the asset. The cost of betterments to, or replacement of, property and equipment is capitalized. When assets are retired or otherwise disposed of, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in the statement of activities for the period. The Company recognized losses included in administrative and other expense of \$1,747 and \$164 in 2006 and 2005 respectively, representing the net book value of property and equipment that was disposed of or no longer in service during the period. Repairs and maintenance costs are expensed when incurred.



**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

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(in thousands of dollars)

ERCOT's depreciable lives (in years) for property and equipment are:

<b>Asset Category</b>	<b>Depreciable Life</b>
Computer Hardware	3
Software	5
Vehicles	5
Furniture and Equipment	7
Mechanical Components	10
Buildings	30
Leasehold Improvements	Life of the lease

**Systems Under Development**

ERCOT continues to develop the information systems and grid operating systems that are being used in its operations. Costs associated with systems under development are evaluated for capitalization in accordance with AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Accordingly, ERCOT capitalized direct costs and related indirect and interest costs incurred to develop or obtain these software systems, most of which are being developed in connection with system development contracts with external firms. Internal costs and contract expenditures not related directly to the development of systems, and related testing activities, are expensed as incurred. Costs from completed projects are transferred to property and equipment when the systems are placed in service.

**Impairment**

ERCOT evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is identified by comparing expected future cash flows, undiscounted and before interest, to the carrying value of the asset. If impairment exists, it is measured as the difference between the net book value of the asset and its estimated fair value. In 2006, ERCOT recorded charges of approximately \$1,729,000 to reduce the carrying value of certain software no longer in use to zero. ERCOT identified no impairments of long-lived assets in 2005.

**Interest Capitalization**

Interest is capitalized in connection with the construction of major software systems and buildings and improvements. The capitalized interest is recorded as part of the asset to which it relates and is amortized or depreciated over the asset's estimated useful life. During 2006 and 2005, capitalized interest costs were \$1,293 and \$591, respectively.

**Market Settlement Liabilities**

Market settlement liabilities primarily represent two types of funds: transmission congestion management funds and Qualified Scheduling Entity (QSE) prepayments of their weekly settlement obligations. QSE settlement amounts are collected and redistributed by ERCOT in the normal course of managing the settlement of ERCOT's markets. Such settlement obligations are generally held for less than fifteen days before distribution to the market in accordance with timetables set forth in ERCOT's Protocols.

ERCOT manages a transmission congestion rights (TCRs) program which includes an annual auction for 60% of the calendar year's available TCRs and monthly auctions for the remaining 40% of TCRs. ERCOT collects and holds the proceeds from the auctions until the proceeds are distributed to QSEs according to provisions of the TCRs program and ERCOT Protocols.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

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(in thousands of dollars)

ERCOT's Financial Standards, adopted by the Board of Directors, include a provision that funds held in conjunction with TCR auctions may be used to fund ERCOT working capital and capital expenditure needs within certain guidelines.

Market settlement liabilities consist of the following at December 31:

	2006	2005
TCR auction funds	\$ 50,094	\$ 58,259
QSE prepayments of settlement obligations	<u>21,176</u>	<u>26,120</u>
Total market settlement liabilities:	<u>\$ 71,270</u>	<u>\$ 84,379</u>

**Security Deposits**

Market participants not meeting certain creditworthiness standards referenced in ERCOT protocols may maintain a cash security deposit with ERCOT in order to mitigate credit risk in lieu of providing alternative means of security such as corporate guaranties, letters of credit, or surety bonds. Cash security deposits are classified as restricted cash.

**Income Taxes**

ERCOT is exempt from Federal income tax under Section 501(c)(6) of the U.S. Internal Revenue Code.

**Debt Issuance Costs**

ERCOT capitalizes issuance costs related to debt. The amounts are classified in non-current assets and amortized over the life of the debt.

**Financial Instruments**

The carrying values reported on the balance sheet for current assets and liabilities and for the line of credit and term notes approximate their fair values. The fair value of the Company's senior notes payable is \$112,709 and \$128,583 as of December 31, 2006 and 2005. The fair value is estimated based on net present value calculations and quoted market prices for similar issues.

ERCOT uses an interest rate swap agreement, which is a derivative instrument, to reduce interest rate risk. The interest rate swap agreement falls within the scope of Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. SFAS No. 133, and related interpretations establish accounting and reporting standards for derivative instruments and for hedging activities. In accordance with SFAS No. 133, ERCOT presents the interest rate swap at fair value in the statement of financial position and recognizes changes in its fair value in the statement of activities.

**Recoveries Relating to Former Employees**

During 2006, ERCOT recorded non-operating income of \$2,376 relating primarily to resolution of issues stemming from fraudulent activity perpetrated by former ERCOT employees in 2003 and 2004. ERCOT recognized \$1,960 in recoveries under corporate insurance policies and \$416 in recoveries under court ordered restitution from former ERCOT employees who engaged in the fraudulent activity.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

(in thousands of dollars)

**3. Property and Equipment**

Property and equipment consists of the following at December 31:

	2006	2005
Computer equipment and software	\$ 248,027	\$ 217,148
Buildings	44,873	45,789
Furniture and fixtures	12,517	11,640
Leasehold improvements	12,327	12,129
Land	246	246
Vehicles	146	155
	<u>318,136</u>	<u>287,107</u>
Accumulated depreciation	(192,158)	(156,931)
	125,978	130,176
Systems under development	37,572	9,605
Construction in progress	704	238
	<u>164,254</u>	<u>140,019</u>
Total property and equipment, net:	\$ 164,254	\$ 140,019

Systems under development consist primarily of costs incurred for the market transformation project described in Note 8.

**4. Notes Payable**

ERCOT's notes payable consist of the following:

	2006	2005
Revolving line of credit	\$ 47,000	\$ -
Term loan	25,000	37,500
Senior notes	109,089	122,726
	<u>\$ 181,089</u>	<u>\$ 160,226</u>

ERCOT has two financing facilities with JPMorgan Chase Bank, a revolving line of credit and a term loan. The revolving line of credit has a maximum amount of available credit of \$125,000 and expires on April 29, 2010. The term loan has a maximum amount of available credit of \$25,000 and expires in November 2008 with principle payments due ratably through November 2008. The interest rates on these facilities are based on the type of advance being made and can be set based on prime rate, a Eurodollar based rate, or other rate as described in the debt agreements. The effective rate of interest at December 31, 2006 was 5.55% for the term loan and was 5.54% for the revolving line of credit. Additionally, ERCOT pays a commitment fee of 0.05% on the unused portion of the revolving credit facility. During 2006, ERCOT incurred commitment fees totaling \$32 in connection with the revolving line of credit.

The JP Morgan credit agreements have several covenants, the most restrictive of which limit borrowings and investments, and requires a certain minimum debt service coverage to be maintained. At December 31, 2006, ERCOT was in compliance with its covenants.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
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(in thousands of dollars)

ERCOT's senior notes bear interest at 6.17% and are due in equal annual payments through May, 2014. ERCOT may prepay the notes subject to make-whole provisions established in the note agreements. The debt agreements have several covenants, the most restrictive of which limits ERCOT's indebtedness and requires the maintenance of an interest reserve equal to the amount of the next installment of interest. The reserve is currently satisfied by available capacity under the revolving line of credit. At December 31, 2006, ERCOT was in compliance with its covenants for the senior notes.

Future maturities of the notes are as follows:

<b>Year Ending December 31</b>	<b>Senior Notes</b>	<b>Term Loan</b>	<b>Total</b>
2007	\$ 13,637	\$ 12,500	\$ 26,137
2008	13,637	12,500	26,137
2009	13,637	-	13,637
2010	13,637	-	13,637
2011	13,637	-	13,637
Thereafter through 2014	40,904	-	40,904
	<u>\$ 109,089</u>	<u>\$ 25,000</u>	<u>\$ 134,089</u>

**Interest Rate Swap Agreement**

In 2005, the Company entered into a variable to fixed interest rate swap agreement (the "Swap") with a financial institution. The notional amount of the Swap is related to a portion of the term loan with JP Morgan and the Swap matures concurrent with the final maturity of the term loan. Under the terms of the Swap, which is effective for the period November 1, 2006 through November 1, 2008 and has a notional value of \$25,000 at December 31, 2006, the Company pays the swap counterparty a fixed rate of 4.5825 percent. In return, the counterparty pays the Company variable interest at LIBOR, which approximates, but does not precisely equal, the rate of interest on the term loan.

The Company is exposed to the risk of nonperformance if the counterparty defaults or if the swap agreement is terminated.

The fair value of the Swap at December 31, 2006 and 2005 was approximately \$214 and \$78, respectively. Changes in the fair value of the Swap are included in other income in the statement of activities.

**5. Employee Benefit Plans**

**Defined Contribution Plans**

During 2006 and 2005, ERCOT sponsored two defined contribution retirement plans: the ERCOT Defined Contribution 401(k) Plan (the "401(k) Plan") and the ERCOT Money Purchase Plan (the "MP Plan"), which are subject to the provisions of the Employee Retirement Income Security Act of 1974. The 401(k) Plan and the MP Plan utilize a third-party administrator to assist in the administration. Employees participating in the 401(k) Plan are fully vested after five years and employees in the MP Plan are fully vested after 3 years. Employees must be 21 years of age to be eligible to participate in either plan.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

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(in thousands of dollars)

For the 401(k) Plan, ERCOT matches 75% of the employee's contribution up to 6% of compensation as defined in the 401(k) Plan document. Employer contributions to the 401(k) Plan were \$1,133 and \$1,595 for the years ending December 31, 2006 and 2005, respectively.

For the MP Plan, ERCOT contributes 10% of a participant's annual salary as defined in the MP Plan document. Employer contributions to the MP Plan were \$4,464 and \$4,121 for the years ended December 31, 2006 and 2005, respectively. The MP Plan was merged with the 401(k) Plan effective April 1, 2006 that resulted in a consolidated ERCOT retirement plan.

**Defined Benefit Plan**

During 2006, ERCOT determined that certain postretirement health benefits which it had offered since 1997 to employees constituted a defined benefit plan subject to SFAS No. 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions*. The plan generally provided that employees hired in 1997 or later who retired between the ages of 55 and 65, and who had ten or more years of service to ERCOT, could continue to participate in the medical, dental and prescription drug coverage available to employees, subject to certain annual and lifetime benefit limits. ERCOT management has reviewed the features of the plan and obtained the advice of actuaries concerning ERCOT's benefit obligations under the plan, and concluded that those obligations were not material. ERCOT terminated the postretirement health benefits plan on June 30, 2006 and it is the opinion of management and ERCOT's general counsel that ERCOT had no liability in connection with the plan at December 31, 2006.

**6. Lease and Contract Commitments**

The Company has noncancellable operating leases and service contracts providing telecommunication services, system infrastructure and office facilities. Most notably, ERCOT leases approximately 45,000 square feet of office space in Austin, Texas under a 120 month lease. The facility lease began in the second quarter of 2001 and includes provisions for two 60 month renewals upon completion of the initial lease term. Minimum payments due under these commitments are:

2007	\$	987
2008		989
2009		980
2010		956
2011		958
Thereafter		139
Total minimum lease payments	\$	<u>5,009</u>

ERCOT recognized \$831 and \$730 of rent expense in 2006 and 2005, respectively.

Other long term liabilities of \$188 at December 31, 2006 are comprised of long term deferred rent credits being amortized over the remaining five year lease term.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

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*(in thousands of dollars)*

**7. Concentrations**

ERCOT provides reliability and market services to QSE's. ERCOT settles the costs of these services by passing through the costs of such services from the providers to the users of such services. In the event that a QSE is unable to make payment on its market obligations, ERCOT's Protocols stipulate that the amount of the default is to be allocated to QSEs that represent load proportionately based on their share of the total load. In order to limit the risks associated with such occurrences, ERCOT requires a cash security deposit, letter of credit, corporate guaranty, or surety bond from QSEs that do not meet certain credit standards. Credit risk related to trade receivables associated with ERCOT's system administration fee is substantially mitigated by the fact that, by Protocol, ERCOT's system administrative fee is paid from market receipts as a first priority before any market obligations are paid.

ERCOT's system administration fee revenue is driven by the demand for electricity rather than the number of QSEs. In the event that any QSE ceased to operate, another QSE would assume the role in response to the demand for electricity. As such, ERCOT believes its exposure to a material reduction in revenues associated with the loss of any QSE is limited.

**8. Accounting for the Effects of Regulation**

ERCOT applies the provisions of Statement of Accounting Standards No. 71, ("FAS 71") which requires regulated entities, in appropriate circumstances, to establish regulatory assets and/or liabilities, and thereby defer the income statement impact of certain charges because it is probable they will be recovered through future billings. During 2006, ERCOT began incurring significant costs associated with the Texas Nodal Market Implementation Project ("TNMIP"). In May 2006 the PUCT issued a rate order that provides for a supplemental rate of 6.63 cents per megawatt hour to fund ERCOT's TNMIP costs. The PUCT also set forth the framework of the TNMIP rates, which provides for explicit recovery of all development costs and all debt service costs over the period of financing the project, which is expected to be completed in 2008. Some of the development costs encompassed in the rate order would otherwise be treated as period costs under generally accepted accounting principles. The net amount of the revenue and costs have been reflected in a regulatory asset account and not reflected in the statement of activities. As of December 31, 2006 ERCOT deferred \$7,735 as a regulatory asset.

**9. Contingencies**

**Sales and Use Tax Audit**

In March 2005 the Texas Comptroller of Public Accounts' office (Comptroller) initiated an audit of ERCOT's sales and use tax payments and obligations for the four-year period covering 2001 through 2004. In March 2006, the Comptroller issued ERCOT its Notification of Audit Results which included the determination that ERCOT has a sales and use tax liability of \$2,778 relating to the audit period. At December 31, 2005 the Company's accrued liability for this obligation was \$2,733. An additional \$45 in interest relating to the first three months of 2006 is included in the sales and use tax assessment by the Comptroller. This amount was not reflected as an accrued liability at December 31, 2006. The liability at December 31, 2005 was recorded based on management's estimate of the probable outcome of this matter based on available information; the audit was incomplete at that time. In 2005, the Company recognized expenses of \$765, relating to the sales and use tax audit.

**Electric Reliability Council of Texas, Inc.**  
**Notes to Financial Statements**  
**December 31, 2006 and 2005**

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*(in thousands of dollars)*

To avoid incurring additional penalties and interest, ERCOT made payments of \$2,782 to the Comptroller on March 29, 2006 for the assessed sales and use tax liability. However, ERCOT is pursuing a hearing of redetermination to potentially reduce the assessed liability and recover some portion of the sales and use tax payment remitted to the Comptroller.

**General Contingencies**

The Company is party to regulatory and legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject. Such proceedings are not anticipated to have a material impact on ERCOT's financial condition, results of operations or cash flow.

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## Overview

- **Projected debt capacity needed through 2008**
- **Review interest rate risk management requirement**
- **Review flexibility requirements**
- **Options considered**
- **Comparison of options**
- **Discussion**
- **Next steps**



- **Projected debt capacity needed through 2008 (includes Nodal and base operations, excluding existing Term Loan and Senior Notes)** <sup>(1)</sup> (in millions)

– Actual debt at Dec 31, 2006	\$ 47
– 2007 projections	
• Baseline capital spend (\$44 less \$12 rev) <sup>(2)</sup>	\$ 32
• Nodal spend (\$114 minus \$28 from Surcharge)	<u>\$ 86</u>
Expected outstanding debt at Dec 31	\$165
– 2008 projections	
• Baseline capital spend (\$21 less \$14 rev) <sup>(2)</sup>	\$ 7
• Nodal spend (\$55 less \$32 from Surcharge)	<u>\$ 23</u>
Expected outstanding debt at Dec 31	\$195
• Estimated liquidity requirement (\$ 30 - \$ 40)	<u>\$ 40</u>
Total expected capacity needed at Dec 31, 2008	\$ 235
– Rounding	<u>\$ 15</u>
– Projected debt capacity needed	\$ 250

<sup>(1)</sup> Assumes Nodal Surcharge of 12.7 cents implemented June 1, 2007

<sup>(2)</sup> Assumes capital expenditures in accordance with the approved 2007 Budget / Strategic Financial Plan

### Review interest rate risk management requirement

Dec 31, 2006    Est Jun 30, 2007

- ERCOT’s Financial Standard requires that: “in no event will ERCOT allow unhedged, variable rate debt to be more than 40% of total debt outstanding”

#### Current and projected debt outstanding

Senior Notes	109.09	95.45
Term Loan	25.00	25.00
Revolver / new borrowing	47.00	106.00

Total Borrowing	181.09	226.45
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#### Fixed / floating blend

Fixed rate debt (%)	74.0%	53.2%
Floating rate debt (%)	26.0%	<b>46.8%</b>
Total	100.0%	100.0%

- Action will need to be taken by June 30 to remain compliant with this requirement

- **Review flexibility requirements for financing alternatives:**
  - Meet near term need for liquidity and interest rate risk management
  - Meet two-year needs efficiently (be expandable and/or minimize admin cost to move from near term to two-year solution)
  - Be cost effective
  - Provide flexibility around pay down of debt
    - surcharge is not yet approved
    - after approval revenue is dependent on MWh, etc.
  - Provide flexible funding as spending schedule is not fixed

- **Option 1 - Expanded or new bank facility w/swap**
  - Likely incorporate another bank to broaden access to bank market
  - Total bank debt at \$275 to \$300 million
    - \$200 - \$225 million Term Loan
      - Includes refinancing existing \$25 million Term Loan
      - Annual pay down through November, 2012
      - Allow for prepayments without penalty
    - \$75 million Revolver
      - Reduce from current level of \$125 million
      - Extend from current maturity in 2010 through 2012
  - \$100 million in Interest Rate Swap(s)
    - To be executed through bidding process
    - Fairness opinion obtained
    - **Will have income statement and balance sheet implications through 2012 with possible variability up to \$5,000,000 or more**

## Electric Reliability Council of Texas, Inc.

### Estimated Financing Needs

Projected at April 10, 2007

	<u>2006</u>	<u>2007</u>	<u>2008</u>
<b>Current debt outstanding and projected</b>			
Senior Notes	109.09	95.45	81.82
Term Loan	25.00	12.50	0
<b>New term loan with swap</b>		<b>100.00</b>	<b>100.00</b>
<b>New term loan w/o swap</b>		<b>40.00</b>	<b>95.00</b>
<b>Revolver</b>	<b>47.00</b>	<b>25.00</b>	-
<b>Subtotal</b>	<b>47.00</b>	<b>165.00</b>	<b>195.00</b>
Total outstanding debt	<u>181.09</u>	<u>272.95</u>	<u>276.82</u>
<b>Fixed / floating blend</b>			
Fixed rate debt (%)	74.0%	76.2%	65.7%
Floating rate debt (%)	26.0%	23.8%	34.3%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

- **Option 2 – Private placement**

- Up to \$175 million of Senior Notes under terms similar to existing Senior Note
  - Fund \$60-80 at close and remainder as delayed draw by March 2008
  - Fixed annual pay down schedule to approximate expected revenues at slight discount
- \$25 million Term Loan – retain and payout
- \$75 to \$100 million Revolver
  - Reduce from \$125 million after final funding under new Senior Notes

## Electric Reliability Council of Texas, Inc. Estimated Financing Needs

Projected at April 10, 2007

	<u>2006</u>	<u>2007</u>	<u>2008</u>
<b>Current debt outstanding and projected</b>			
Senior Notes	109.09	95.45	81.82
Term Loan	25.00	12.50	0
<b>Senior Notes</b>		<b>100.00</b>	<b>175.00</b>
<b>Revolver</b>	<b>47.00</b>	<b>65.00</b>	<b>20.00</b>
<b>Subtotal</b>	<b>47.00</b>	<b>165.00</b>	<b>195.00</b>
Total outstanding debt	<u>181.09</u>	<u>272.95</u>	<u>276.82</u>
<b>Fixed / floating blend</b>			
Fixed rate debt (%)	74.0%	76.2%	92.8%
Floating rate debt (%)	26.0%	23.8%	7.2%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

## Comparison of options

	<u>Bank Debt w/ Swaps</u>	<u>Private Placement</u>
Pricing	<b>Comparable</b>	<b>Comparable</b>
Flexibility of terms	<b>More flexible</b>	Less flexible
Flexibility in obtaining amendments	<b>More flexible / more timely</b>	Less flexible / more formal process
Prepayment penalty	<b>No</b>	Yes
Ease of execution	<b>Easier</b>	Harder
Fix rate debt	Must execute interest rate swaps to "fix" the debt rate.	<b>Straightforward</b>
FAS 133 accounting valuations	Yes, must use FAS 133 accounting. May have valuation swings of \$3 - \$5 million over life of debt.	<b>No</b>



- **Discussion**

- ERCOT generally believes that Option 1 provides the most flexibility both near and long term
- However, ERCOT believes both financing options meet ERCOT needs and would like to obtain input from F&A as to their preference, given the relative merits of each option.

- **Next steps**

- If F&A chooses to move forward with bank debt financing, F&A can recommend the BOD approve the proposed resolution.
  - ERCOT staff can then begin executing required documents
- If F&A chooses to move forward with private placement
  - ERCOT staff can work with agent to prepare Offering Memorandum and other documents
  - ERCOT staff would require approval of a resolution at the May 2007 BOD meeting to execute the transaction
- Vote (decision template & resolution included with BOD packet)

## Proposed 2008 Development Schedule

Date	Action
Wednesday, Apr. 18	Finance & Audit Committee - Preliminary Budget & Business Plan Discussion
Friday, May 11	NERC - First Draft - Preliminary Business Plan and Budget Due (Statutory Functions)
Wednesday, May 16	Finance & Audit Committee/Board - Preliminary Budget Presentation and Final Business Plan Review
Monday, May 21	Open Meeting - Business Plan and Proposed Budget Presentation
Monday, May 28	Finance & Audit Committee Special Meeting - Budget Review and Recommendation (if necessary)
Friday, Jun. 1	NERC - Final Business Plan and Budget (Draft) due to NERC (Statutory and Non-Statutory Functions)
Thursday, Jun. 19	Board - Final Budget Approval
Thursday, July 12	NERC - Final Board Approved Budget Due

### ERCOT Market Credit Status

as of 2/28/2007					as of 3/31/2007					
	# of QSEs*	Estimated Aggregate Liability (\$)	% of EAL	Total Unsec Credit Limit / Security Posted		# of QSEs*	Estimated Aggregate Liability (\$)	% of EAL	Total Unsec Credit Limit / Security Posted	
<b>Exposure in the ERCOT Market (owed to ERCOT)</b>										
<u><b>QSEs that meet ERCOT Creditworthiness Standards</b></u>										
Ratings over BBB-	5	34,012,392	9%	48,000,000	U	5	31,409,390	9%	58,000,000	U
<u><b>QSEs that do not meet ERCOT Creditworthiness Standards</b></u>										
Ratings below BBB- or not rated	41	114,102,821	32%	231,014,787	S	43	160,366,631	46%	286,824,934	S
Cash & Letters of Credit	14	210,595,842	59%	478,442,122	S	13	157,412,395	45%	444,275,122	S
Guarantee Agreements										
<b>Total Exposure</b>	<b>60</b>	<b>358,711,055</b>	<b>100%</b>			<b>61</b>	<b>349,188,416</b>	<b>100%</b>		
<b>Other QSEs in the ERCOT Market (ERCOT owes)</b>										
<u><b>QSEs that meet ERCOT Creditworthiness Standards</b></u>										
Ratings over BBB-	13	(16,560,842)	-23%	106,026,345	U	13	(11,891,788)	-24%	96,026,345	U
<u><b>QSEs that do not meet ERCOT Creditworthiness Standards</b></u>										
Ratings below BBB- or not rated	48	(38,858,162)	-54%	28,797,160	S	50	(25,195,642)	-51%	22,104,971	S
Cash & Letters of Credit	8	(17,162,398)	-24%	155,200,000	S	8	(12,797,854)	-26%	155,200,000	S
Guarantee Agreements										
<b>Total</b>	<b>69</b>	<b>(72,581,401)</b>	<b>-100%</b>			<b>71</b>	<b>(49,885,284)</b>	<b>-100%</b>		
<b>Total</b>	<b>129</b>					<b>132</b>				

U: Unsecured since these QSEs meet the creditworthiness standards  
 S: Secured i.e. required to post collateral since these QSEs do not meet the creditworthiness standards

**ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.**  
**RISK MANAGEMENT EVENT PROFILE MATRIX (as of April 1st, 2007)**

Strategic Position	Operational Excellence	Market Facilitation	Grid Reliability	Reporting	Compliance
<p> <b>Strategy Development</b> Objective setting adequately incorporates informed stakeholder input, market realities and management expertise</p> <p>ERCOT Board and Staff need awareness of ERCOT's short and long-range strategic plan. The Nodal project and the proposed ERO/RE environment have been adequately factored into plans.</p>	<p> <b>Performance Monitoring</b> Clearly defined performance metrics linked to mission and goals; actively monitored, status communicated and corrective action taken</p> <p>Management has rolled out a revision of the Executive Dashboard based on defined KPI's and have instituted regular Quarterly Business Reviews to discuss key business activities in addition to weekly executive team meetings, constant grid monitoring, IT SLA's, and generation / transmission assessments.</p>	<p> <b>Customer Choice</b> Market design promotes efficient choice by customers of energy providers with effective mechanisms to change incumbent market participants as desired.</p> <p>IT components supporting Customer Choice are currently not at the desired levels to meet SLA's. Successful replacement of SeeBeyond Application with TIBCO has had a significant impact on Customer Choice operations which has reduced overall levels of risk, however other IT related Retail issues continue.</p>	<p> <b>Grid Operations</b> Information required to operate the grid is efficiently gathered and appropriate tools are prudently configured to efficiently operate the system</p> <p>Current tools utilized by the System Operator (including the State Estimator and the accuracy/availability of SCADA data) need further improvement. An Operator Training Simulator will not be operational until April. Increasing and more difficult to forecast system loads represent a risk in the shoulder months.</p>	<p> <b>Review Practices</b> Prudent measures are taken to insure that company disclosures are properly vetted and not misleading</p> <p>Board of Director's review of management activities on an ongoing basis assists in ensuring proper review and disclosure practices.</p>	<p> <b>Legal &amp; Legislative</b> Operations are conducted in compliance with all laws and regulations and current and proposed legislation is understood and communicated</p> <p>Increased efforts have been made to inform members of the legislature about ERCOT and the performance of its functions. Enhanced efforts are being undertaken to maintain records according to established record retention policies.</p>
<p> <b>Mission and Goals</b> Corporate objectives and performance standards are understood and followed</p> <p>Current management initiatives related to goal setting and the development of Key Performance Indicators (KPI's) have increased awareness of organizational goals and related to high-level corporate objectives and priorities for individual divisions, departments, and employees.</p>	<p> <b>Business Practices</b> Business planning, processes and management standards are effective and efficient</p> <p>Disaster recovery plans are currently below desired expectations. Additional development activities required to implement and test these procedures. However solid overall business practices are confirmed via: Internal and External audit, Operational review, Regional Entity / Compliance, and RMC and Disclosure Committee review.</p>	<p> <b>Nodal Implementation</b>  Nodal Implementation is progressing in a timely fashion on budget and schedule within a defined scope.</p> <p>Risks continue to exist with scope management and deliverable tracking. Scope management has improved. Vendor resourcing and internal staffing has improved significantly. Risks exists in time line management, software quality (unknown) and software integration. Market readiness assessment is underway. Financial risk over approval of surcharge exists until PUCT ruling are complete.</p>	<p> <b>Planning</b> Long-range planning methods enable efficient responses to necessary system changes to maintain reliability standards</p> <p>Lack of timely and accurate information necessary to build reasonable system models and forecasts and insufficient ability to conduct long-range (6-10 years out) planning resulting in possible inefficiencies in ERCOT's transmission expansion plan.</p>	<p> <b>Disclosure</b> Reporting and other disclosures to intended parties is timely, accurate and effective</p> <p>A Disclosure Committee has been institutionalized to discuss and report issues related to external reporting and compliance.</p>	<p> <b>Internal Control Compliance</b> Internal Control Compliance, processes and management standards are effective and efficient</p> <p>Audit findings are actively monitored by management as well as Internal Audit. Additional training activities are required to ensure all staff members are aware of ongoing internal control compliance processes and procedures.</p>
<p> <b>Reputation</b> Positive perceptions by stakeholders typically lead to less cost and greater flexibility resulting in enhanced enterprise value</p> <p>High visibility of initial Nodal implementation impact ERCOT reputation as could increased scrutiny on ERCOT activities occurring during the bi-annual state legislative session. Additional focus is on ERCOT's transmission and generation adequacy planning as a valued, objective, and knowledgeable resource to regulators, legislators, and the market.</p>	<p> <b>Work Force</b> Organization design, managerial and technical skills, bench strength and reward systems are aligned with corporate goals</p> <p>The number of open employment positions has declined to less than 55 openings but certain positions in the IT area remain hard to fill. Contractor usage remains high. Overcrowding has lead to morale issues. Employee turnover has remained consistent at 11%. The completion of the compensation structure and the Employee Standards Manual will provide improved operations and consistency in the future.</p>	<p> <b>Counterparty Credit</b> Bankruptcies and other capital deficiencies increase the cost for market participants and potentially impact Grid reliability through participant failure</p> <p>Processes for removing defaulting participants from the market increases the potential for credit losses. A medium to large market participant default could materially impact the ERCOT market, grid reliability, and ERCOT's reputation. Recent PRR's related to shortening the timeframe related to drops to POLR have reduced exposure by an estimated 37%.</p>	<p> <b>Bulk System Resources</b> Market Participants have constructed and made available adequate bulk electric grid resources</p> <p>Uncertainty surrounding generation projects, installed and operational capacity, and the high dependency on natural gas in Texas' generation fleet may impact reliability. The risk exists for a hotter than normal summer or cooler winter to increase load demand to a level that reduces reserve margins below acceptable minimum levels.</p>	<p> <b>Communication</b> Internal and external communications are timely and effective</p> <p>A crisis management project for communications has been completed and ERCOT has restructured its legal and communications departments. Issues remain relating to the effective communications of retail systems outages on an ongoing and consistent basis.</p>	<p> <b>Industry Standards</b> Business practices provide stakeholders with required assurances of quality</p> <p>SAS 70 Audit Issues and qualifications remain to be addressed with remediation activities underway to address preliminary findings. Also, new NERC Physical / Cyber Security Standards have been approved and are in the process of being adopted. In addition to SAS 70 Audit Issues, ERCOT has outstanding issues with filings related to its retirement and benefit plans.</p>
<p> <b>Fiscal Management</b> ISO design requires competent, prudent and cost effective provision of services</p> <p>Current fiscal practices are effective in managing and controlling costs. Adequacy of Nodal budget and staffing allocation to be addressed through the updated Nodal surcharge filing.</p>	<p> <b>Technology Infrastructure</b> Information systems and data are effectively managed and are reliable</p> <p>Risks in Retail system stability still exist. Infrastructure and application review by an outside firm will be initiated and stability implementation plan will be developed by end of Q2 2007. Data Center power constraints are being reviewed, however there are no plans to add more power in the near future.</p>	<p> <b>Administration, Settlement &amp; Billing</b> Market rules are fairly applied to all participants and accounting is timely and accurately reflects electricity production and delivery</p> <p>ERCOT's settlement/dispute processes has a significant number of ADR's related to the RPRS policy debate outstanding, however these are being addressed in a timely fashion. Increased levels of ADR's may pose a future risk if they are no longer able to be timely addressed.</p>	<p> <b>Operational Responsibility</b> Market participants conduct their operations in a manner which facilitates consistent grid reliability</p> <p>Response of generators to grid operation events has been improving. Enhanced enforcement of NERC standards will exist through the ERO / RE structure.</p>	<p> <b>Adequacy and Integrity</b> Robust processes exist to support management assertions embodied within financial reports</p> <p>Financial and Operations management information has been redesigned to enable management to effectively monitor and manage the business.</p>	<p> <b>Regulatory Filings</b> Evidence, testimony and other supporting materials are compelling and successful</p> <p>Filings are completed timely and accurately.</p>

Legend: Elevated Risk Level

Reduced Risk Level

(New Risk Categories / Descriptions Indicated in Green)

**Rationale for Category Risk Assessment Changes**

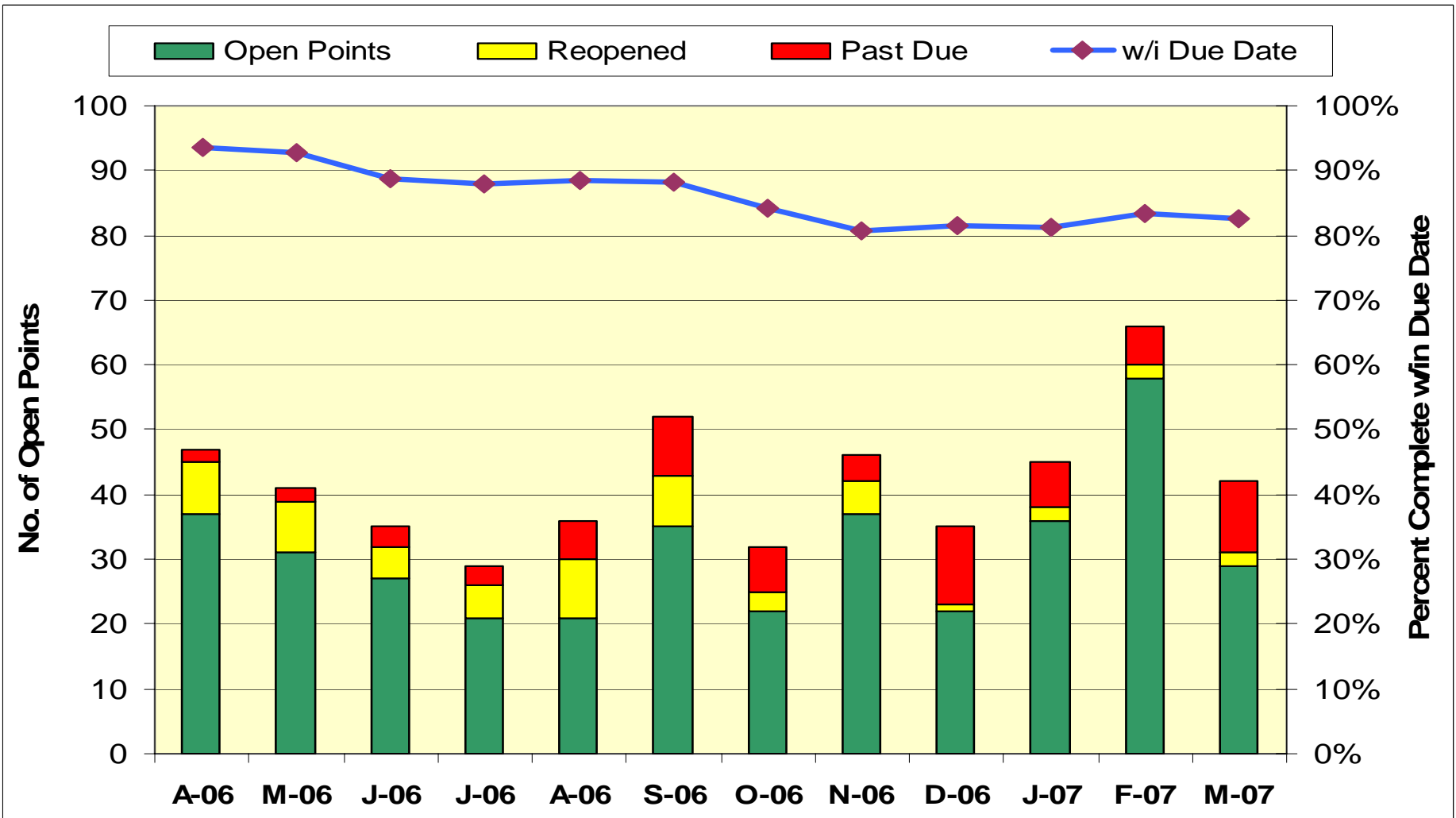
Nodal Implementation

Upgrade: Red > Yellow

**ERCOT has further scoped the nodal project, hired additional key staff members, and funding has largely been obtained.**

# Committee Brief: ICMP – Status of Open Audit Points

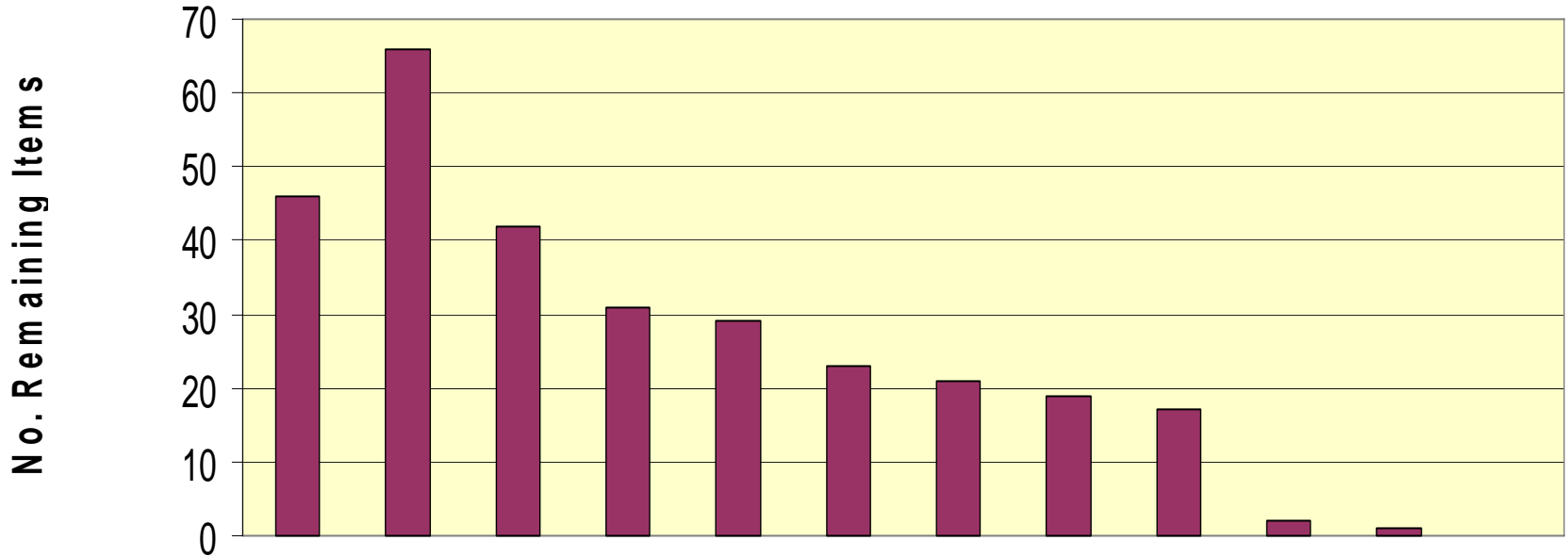
Cheryl Moseley



Audits Completed	2	0	3	0	2	2	0	3	2	5	2	2
Points Added	5	0	15	0	7	30	2	28	8	36	35	0
Points Completed	13	6	21	6	0	14	22	14	19	26	14	24



## Projected Audit Point Progress



	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
■ Audit Points	46	66	42	31	29	23	21	19	17	2	1	0



## **Audits Completed (last 3 months)**

### Internal Audits

- Business Continuity Plan
- Procurement & Contract Administration
- SCADA Applications
- Registration/Qualification of Market Participants
- Budget Process
- Nodal Recruiting
- Nodal Ethics Compliance

### External Audits

- Texas Nodal Program Controls - Review #2 (IBM-managed by IAD)
- Securicon Vulnerability Assessment (Managed by IAD)

## **Open Audits**

### Internal Audits

- SAS70 Pre-Audit Testing
- Accounts Payable
- Nodal Timetracking
- Nodal Signing Authority/Delegation of Authority
- PMO (Non-nodal)
- Procurement Short String Approval Process

### External Audits

- 2006 Financial Audit (PwC)
- 2007 SAS70
- 2006 Final MPP
- Texas Nodal Program Controls – Review #3 - IBM (Managed by IAD)

## **Planned Audits (next 3 months)**

### Internal Audits

- Nodal PMO
- Protocol/Market Guide Approvals/Revisions
- Regional Entity Planning & Budget
- Contract Audit (21<sup>st</sup> Century)
- NERC Compliance (TRE & IAD)
- Congestion Mgmt. (TCRs)
- Nodal Acctg./Allocation

### External Audits

- NOTE: Internal Audits performed by IAD, unless otherwise noted.

**Consultation/  
Analysis Reports  
Completed**  
(last 3 months)

External Assessments

- 1 security assessment with combined consulting service completed in February

**Open Consultation/  
Analysis Reviews**

External Assessments

- 1 security assessment started in March

**Planned Consultation/  
Analysis Reviews**  
(next 3 months)

External Assessments

### 2007 Year to Date Project Activity by Division









	Phase	Not Started	Initiation	Planning	Execution	Closing	Completed	Cancelled	On Hold	Totals by CART	Go-Live*
CART	Corporate Operations	19	1	5	6	3				34	2
	IT Operations	7		1	6				1	15	
	Market Operations	10		3	10	7	1	6	1	38	
	System Operations	2	1	7	5	5	4	1	3	28	3
	<b>Totals by Phase</b>	<b>38</b>	<b>2</b>	<b>16</b>	<b>27</b>	<b>15</b>	<b>5</b>	<b>7</b>	<b>5</b>	<b>115</b>	<b>5</b>

\*NOTE: 1 CO project went live in the month of March. See subsequent slides in deck.

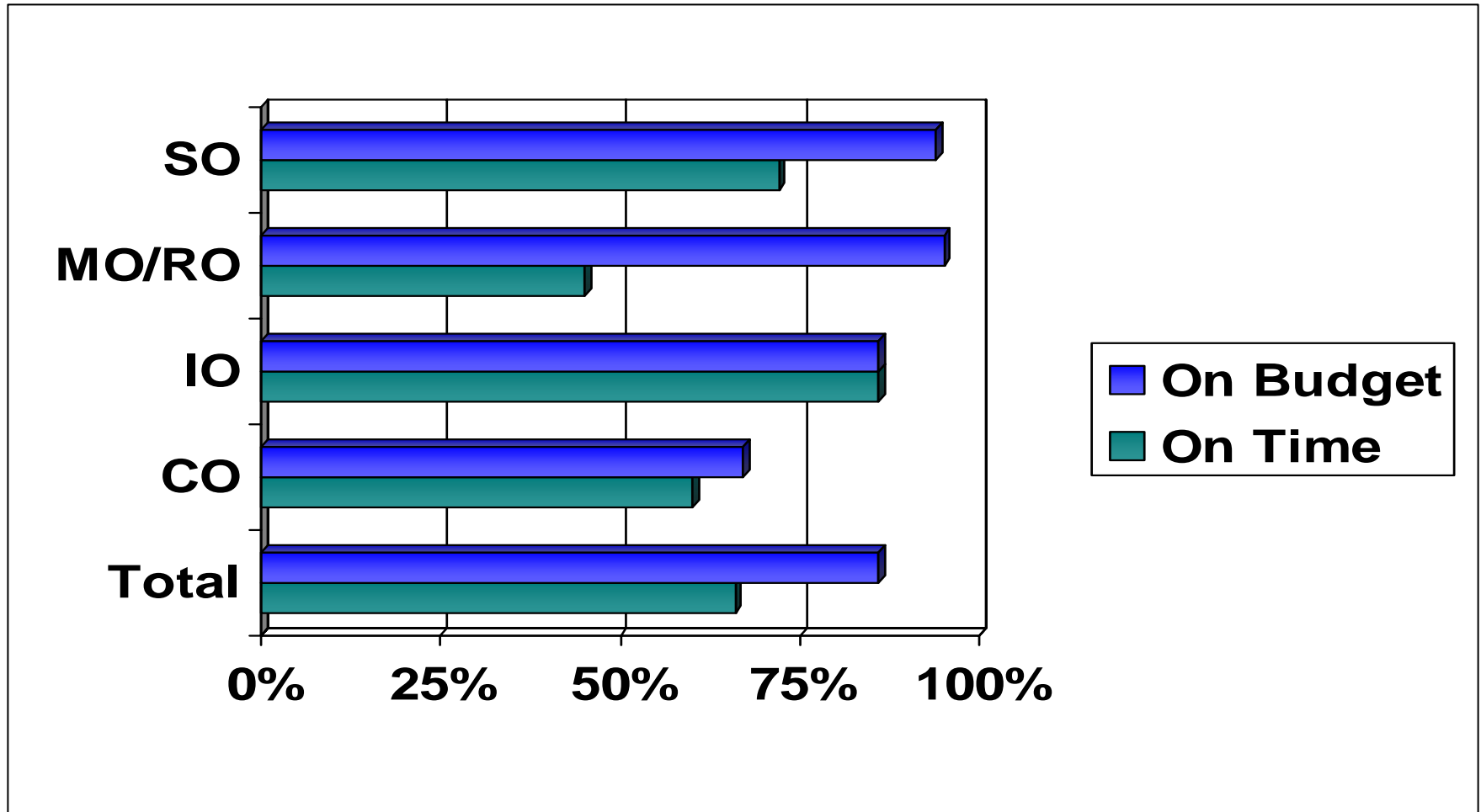
### Year to Date Project Priority List (PPL) Status

PPL Iterations	Origination	Project Phases								Subtotal	Grand Total
		Not Started	Initiation	Planning	Execution	Closing	Completed	On Hold	Cancelled		
Original 2007 PPL											76
	PUCT	1			1	1		2		5	
	Market	3		1	3		1		3	11	
	ERCOT	28	1	9	10	1		2	4	55	
	Compliance			4				1		5	
	System Maintenance									0	
Unexpected Carry Over From 2006											27
	PUCT						2			2	
	Market	1			1	1	2			5	
	ERCOT			1	7	12				20	
	Compliance									0	
	System Maintenance									0	
New Projects Added (Since PPL Approval in August 2006)											12
	PUCT		1							1	
	Market	2								2	
	ERCOT	3		1	5					9	
	Compliance									0	
	System Maintenance									0	
2007 PPL totals as of January 31, 2007											115
	PUCT	1	1	0	1	1	2	2	0	8	
	Market	6	0	1	4	1	3	0	3	18	
	ERCOT	31	1	11	22	13	0	2	4	84	
	Compliance	0	0	4	0	0	0	1	0	5	
	System Maintenance	0	0	0	0	0	0	0	0	0	
Totals by Project Phase		38	2	16	27	15	5	5	7	115	

### Projects Over \$1 Million

Projects Over \$1M	Total Budget	Total Committed To Date	Metrics	
			Duration/Information (Sponsor)	Phase/Scheduled Completion
<b>(MO/RO) PR-40038_01: TX SET 3.0</b>	<b>\$1.628M</b>	<b>\$ .90M</b>		
<i>Currently in Execution (R. Giuliani)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
<b>(SO) PR-40090_02: Operator Training Simulator (2005-2007)</b>	<b>\$3.8M</b>	<b>\$2.56M</b>		
<i>Training Simulator System for Operators (S. Jones)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
<b>(MO/RO) PR-50024_01: Enhancements to SCR727 (2005-2007)</b>	<b>\$1.9M</b>	<b>\$1.15M</b>		
<i>Entered into Execution (R. Giuliani)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
<b>(CO) PR-60099_01 TCC1 Build-Out Phase One</b>	<b>\$2.362M</b>	<b>\$ .063M</b>		
<i>Currently in Planning (S. Jones)</i>	<i>Expected Completion/3rd Qtr 2007</i>			

## 2007 Completed and Active Projects Performance



### Capital Projects – Budget vs. Actuals for Projects Completed YTD

Completed Projects	Baseline Budget	Actuals	\$ (Over)/Under Baseline Budget	% (Over)/Under Baseline Budget		
PR-30105 (Congestion Management Reports)	105,300	86,716	18,584	18%	-	18,584
PR-60002_01 (Increase Number of Seats for Study Markets Clearing Engine)	179,823	86,718	93,105	52%	-	93,105
						(2 projects)
<b>NOTES:</b>						
(a) Baseline Budget does not include change controls that were approved without granting a new baseline budget.						

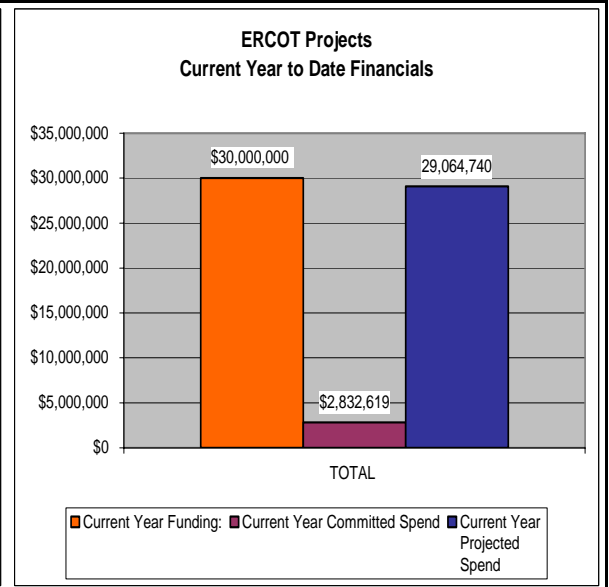
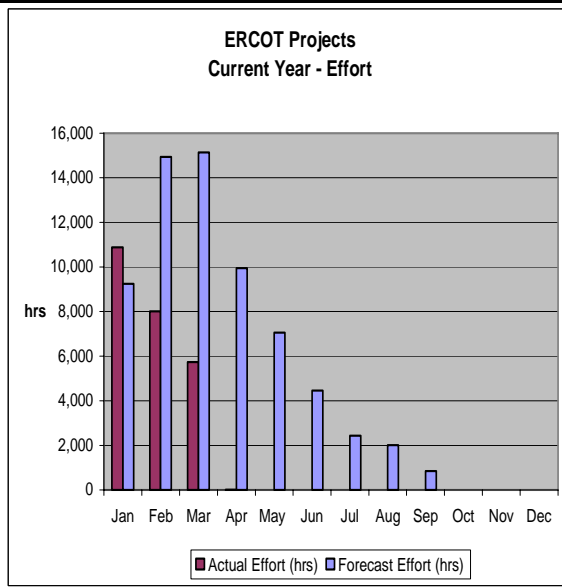
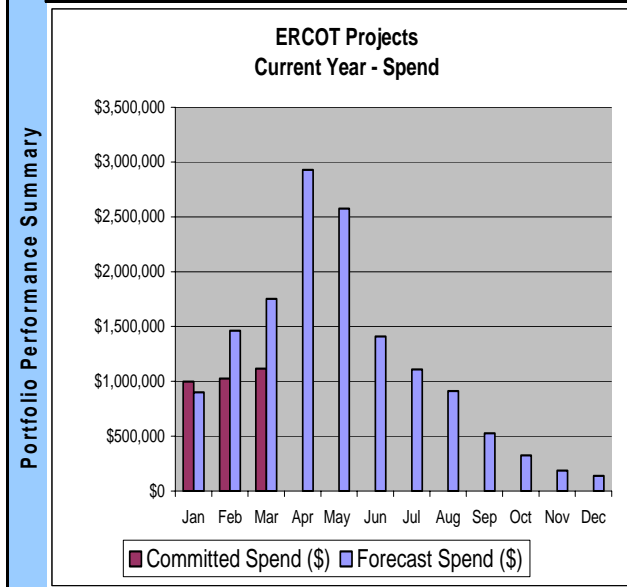
## Go Live Projects for March

- **PR-60093\_01 Gate Operators and Pedestals**
  - **Scope:** Replace gate operators and arm operators in TCC1 and TCC2. Replace gate operators on the service entry
  - **Deliverables:**
    - TCC1 arm and gate operators
    - TCC2 arm and gate operators
    - Service gate operators
    - TCC1 and TCC2 gate “skirt” to meet UL 325
  - **Timeline:** 10/1/2006 - 3/31/2007



### Enterprise Projects Summary Report

ERCOT Overall Projects Report				Reporting Period:		3/30/2007	YTD				
Summary	ERCOT Projects Leadership		Projects in ERCOT's Portfolio				Portfolio Performance				
	Executives		On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk	Milestones
	Kent Saathoff	Ray Giuliani	5	2	15	28	15	Y	G	G	\$ -
	Ron Hinsley	Steve Byone	Completed	5	Total Active		65				
		Cancelled	7	Projects Not Started:		37	Prior Year Funding:	\$0	Current Year Funding:	\$30,000,000	



Notes



## Future Agenda Items – May 2007

- **Internal Audit Department standing report (Executive Session)**
- **Review results of 401(k) audit**
- **Update on preliminary 2008 budget assumptions**
- **Update on Texas Regional Entity 2008 Budget**
- **Committee briefs**

## Quarter 1

- √ •Elect officers and confirm financial qualifications
- Review Finance Audit Committee charter
- √ •Approve the Guidelines for Engagements of External auditors for Other Services (pre-approval policy)
- √ •Required written communication and discussion of auditor independence
- √ •Review scope of annual financial audit
- Report by CWG Chair on ERCOT credit policy
- Vote on CWG Chair/Vice Chair

## Quarter 2

- Report results of annual independent audit to the Board
- Report of external auditor pre-approval status/limits
- Review the procedures for handling reporting violations
- Review conflict of interest and ethics policies
- Review results of annual audit (including required communications)
- Review and approve ERCOT Annual Report
- Review operating plan and budget assumptions
- Review and approve Internal Audit Department Charter

## Quarter 3

- Appoint the independent auditors for upcoming year
- Approval of independent auditor fees for upcoming year
- Assessment of compliance, the internal control environment and systems of internal controls
- Review and approval of annual operating budget
- Report by CWG Chair on ERCOT credit policy
- Review updated year-end forecast

## Quarter 4

- Approve audit committee meeting planner for the upcoming year, confirm mutual expectations with management and the auditors
- Review and approval of Financial & Investment policies
- Approve scope of internal auditing plan for upcoming year
- Assessment of the adequacy and effectiveness of the Internal Audit staff
- Perform Finance & Audit committee Self Assessment
- Review requirements for membership in CWG
- Review and approve CWG charter
- Review updated year-end forecast

## Recurring Items

- Review minutes of previous meeting
- Report monthly matters to the Board (chair)
- Review EthicsPoint activity
- Review significant audit findings and status relative to annual audit plan
- Review investment results quarterly