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ERCOT APPLICATION FOR
APPROVAL OF A REVISED NODAL
MARKET IMPLEMENTATION
SURCHARGE AND REQUEST FOR
INTERIM RELIEF

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PUBLIC UTILITY COMMISSION
FILING CLERK
OF TEXAS

**ERCOT REQUEST FOR INTERIM APPROVAL OF A REVISED
NODAL MARKET IMPLEMENTATION SURCHARGE**

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DOCKET NO. _____

ERCOT APPLICATION FOR	§	PUBLIC UTILITY COMMISSION
APPROVAL OF A REVISED NODAL	§	
MARKET IMPLEMENTATION	§	OF TEXAS
SURCHARGE AND REQUEST FOR	§	
INTERIM RELIEF	§	

**ERCOT REQUEST FOR INTERIM APPROVAL OF A REVISED
NODAL MARKET IMPLEMENTATION SURCHARGE**

COMES NOW, the Electric Reliability Council of Texas, Inc. ("ERCOT"), and, pursuant to P.U.C. PROC. R. § 22.252 and the Commission's prior Orders in Docket Nos. 32686 and 35428, respectfully requests that the Commission grant ERCOT interim approval of a revised Nodal Market Implementation Surcharge ("Nodal Surcharge"). ERCOT requests approval of a Nodal Surcharge of \$0.38 per MWh, to be effective beginning February 1, 2009 and terminating on the date the Commission approves implementation of a final Nodal Surcharge. In support of its request for interim approval, ERCOT states as follows:

I. INTRODUCTION AND BACKGROUND

1. In Docket No. 35428, *Application of ERCOT For Approval of a Revised Nodal Market Implementation Surcharge*, the Commission approved a Nodal Surcharge of \$0.169 per MWh "in order to recover \$311.3 million, which represents the estimated cost of the Texas Nodal Market Implementation Program ("Nodal Program"), including the costs of financing portions of the Nodal Program with debt."¹ The Nodal Surcharge approved by the Commission was established to "collect revenues to pay for the Nodal market implementation project by a flat fee, which would use borrowed funds and new fees, over the surcharge period of 2007-2012."²

¹ Docket No.35428, *Order*, at 1.

² *Id.* at 7 (FOF 8).

2. As the Commission is aware, ERCOT announced on May 20, 2008 that the Nodal market will not open on December 1, 2008 as planned. ERCOT will not be in a position to complete program requirements by that date due to several factors, including key vendor software delays, higher data volumes than initially anticipated, increased testing needs to resolve defects, the incorporation of new Protocols to resolve market defects, and the project being much more complex than anticipated. Since the May 2008 announcement, the delay in the opening of the Nodal market has been discussed extensively among Market Participants, at Commission Open Meetings, and at ERCOT Board of Directors and committee meetings.

3. At the direction of the Commission, ERCOT staff is working with Commission staff and consultants from Charles River Associates to refresh the cost-benefit analysis ("CBA") of the implementation of a Nodal market in the ERCOT region. The expected date of the delivery of the CBA to the Commission is December 15, 2008.

4. Concurrent with the development of the CBA, ERCOT is conducting a comprehensive review of the Nodal implementation program. ERCOT expects this review will culminate in a revised schedule and budget for completion of Nodal market implementation. Any final Nodal schedule and budget prepared by ERCOT must necessarily take into account input from the Commission after the Commissioners analyze the Nodal CBA.

5. If the Commission determines, after review of the CBA, that ERCOT should continue to implement the Nodal market pursuant to the Nodal Protocols previously approved by the Commission,³ as amended by subsequent Nodal Protocol Revision Requests ("NPRRs"), the cost of completing the Nodal Program will necessitate an increase in the \$0.169 per MWh Nodal Surcharge.

³ The Commission approved the Nodal Protocols in Docket No. 31540, *Proceedings To Consider Protocols To Implement A Nodal Market In The Electric Reliability Council of Texas Pursuant To P.U.C. SUBST. R. 25.501* (2006).

6. ERCOT cannot present a meaningful, thoroughly vetted Nodal schedule and budget until the Commission analyzes the conclusions of the CBA, ERCOT completes its Nodal Program review, and the appropriate market committees have ample opportunity to review and comment on the new schedule and budget. Nevertheless, ERCOT must continue to expend resources to keep Nodal Program staff on the job and to prevent Nodal implementation from losing ground while ERCOT and the Commission consider the best long-term solutions.

7. Before the long-term Nodal implementation budget and schedule are in place, ERCOT will reach the limit of the \$311.3 million in spending authorized by the Commission for recovery from the Nodal Surcharge.⁴ The current surcharge is not sufficient to recover additional Nodal implementation costs because it was formulated based on the assumption that Nodal implementation activities funded by the Nodal Surcharge would be complete by January 1, 2009.

8. The Nodal Surcharge of \$0.169 per MWh will not meet ERCOT's revenue funding needs for completing Nodal implementation unless ERCOT departs significantly from its desired debt/revenue ratio and funds a greater share of Nodal implementation by incurring debt beyond the level the Commission has approved in prior Orders. Moreover, the general tightening of the credit markets have made it more difficult for ERCOT to secure large amounts of new debt, and have made the credit facilities ERCOT can secure substantially more expensive. In these circumstances, ERCOT believes it would be prudent to minimize additions to the existing debt load generated by the Nodal implementation program (which stands at approximately \$200 million as of the date of this filing).

⁴ Docket No. 35428, *Order*, at 6 ("The Commission finds that a Nodal surcharge of \$0.169 per MWh, collected on a flat-fee basis as proposed by ERCOT, to recover \$311.3 million is appropriate, and should be employed to assist ERCOT in funding the expenses incurred in implementing the Nodal market.").

9. If the Commission determines that ERCOT should complete its work on Nodal implementation pursuant to the approved Nodal Protocols, ERCOT must negotiate new credit facilities for the debt used to finance the Nodal Program. In order to obtain the most favorable debt arrangements, ERCOT believes it should be in a position to document that the bulk of the ongoing costs of Nodal implementation will be recovered from revenues, namely, from a Nodal Surcharge revised to reflect the extended completion date of Nodal implementation.

10. Due to the overlapping timing of the CBA analysis, ERCOT's internal Nodal Program review, the examination and vetting of a new Nodal implementation schedule and budget by various stakeholder committees and third-party reviewers, and the imminent exhaustion of ERCOT's Commission-approved spending authority, ERCOT believes that financial prudence dictates that it request an interim increase in the Nodal Surcharge to "bridge" Nodal implementation financing from today's situation to the time when a new approved Nodal schedule and budget provide the basis for ERCOT to request Commission approval of a final Nodal Surcharge.

11. In order meet its continuing obligations to fund Nodal implementation efforts, and since ERCOT will reach the limit of Commission-approved spending authority for Nodal implementation, ERCOT cannot delay its request for a revised Nodal Surcharge until the completion of the process necessary to finalize a new Nodal implementation schedule and budget. ERCOT therefore requests interim relief as described below.

II. REQUEST FOR INTERIM RELIEF

12. ERCOT respectfully requests that the Commission order, on an interim basis, that the Nodal Surcharge factor increase to \$0.38 per MWh. ERCOT requests that the interim Nodal Surcharge become effective by February 1, 2008, and remain in effect until the Commission approves a final Nodal Surcharge based on review of the ERCOT Nodal implementation schedule and budget developed after the Commission issues its recommendations based on the CBA.

13. ERCOT requests authorization to bill the revised Nodal Surcharge on a month-to-month basis in order to recover ongoing development costs of the Nodal implementation program. ERCOT proposes that it replace the interim Nodal Surcharge requested herein with a Commission-approved final surcharge once the Commission reviews the forthcoming Nodal implementation schedule and budget, after it is approved by ERCOT's Board of Directors.

14. The Nodal Surcharge is calculated to recover the projected average monthly expenses associated with continuing work on Nodal implementation. ERCOT based its estimate of monthly expenditures on historical data. In 2007 and 2008, the average monthly spending on Nodal development was approximately \$12.0 million. In the interest of preventing gaps in funding during the period the interim Nodal Surcharge is in effect, ERCOT projected a monthly spending rate of \$12.0 million. The \$0.38 per MWh interim Nodal Surcharge is set at a level that will recover seventy-five percent (75%) of the projected monthly spending of \$12.0 million from Nodal Surcharge revenues during the period it is in effect.

15. In January 2008, ERCOT forecasts that it will reach the limit of spending authorized by previous Commission orders for Nodal implementation. ERCOT requests that the Commission approve continued use of the surcharge for funding Nodal Program costs in addition

to the \$311.3 million currently authorized. ERCOT will be prepared to identify the total amount to be recovered from the Nodal Surcharge when it files for approval of the final Nodal Surcharge after adoption of a revised schedule and budget by ERCOT's Board of Directors.

16. ERCOT's interim surcharge request relies on the same "flat-fee" methodology previously approved by the Commission. The substantial increase over the existing Nodal Surcharge is due to ERCOT's need to increase the revenue contribution to Nodal development. At year end 2008, the revenue contribution to Nodal Program development provided by the Nodal Surcharge accounts for 28% of Nodal Program spending. The remainder of the Nodal Program has been financed with debt, and the total debt load associated with Nodal implementation stands at just under \$200 million. ERCOT recommends that, given current credit market conditions, the increased cost of available credit, and the institutional risks to ERCOT of accumulating more debt, the interim Nodal Surcharge be set at the level requested, which would permit ERCOT to recover 75% of projected average monthly Nodal implementation expenses from revenue rather than debt funding.

17. ERCOT's use of the Nodal Surcharge to increase the revenue funding of Nodal Program operations will impact its previously approved plans for repayment of existing Nodal Program debt. When the Nodal Program was scheduled to end by January 1, 2009, Nodal Surcharge revenues collected in 2009 and beyond were scheduled to be used to retire debt incurred to complete Nodal implementation. Since those same revenues must now be dedicated to continued work on the Nodal Program, ERCOT requests Commission approval of the deferral of repayment of Nodal Program debt until revenues collected from the surcharge are sufficient to ~~re~~cover current cash outlays and to begin servicing outstanding Nodal Program debt.

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18. ERCOT requests that the Commission's order be interim only, so that the Commission can revisit the Nodal Surcharge level after its CBA review and ERCOT's completion of a revised Nodal schedule and budget. ERCOT proposes that it file a supplemental application seeking approval of a final Nodal Surcharge and Nodal implementation completion date when a fully developed schedule and budget has been approved by the ERCOT Board of Directors, after review by all appropriate stakeholder entities.

19. The factual basis for ERCOT's request is detailed in the testimony of ERCOT President and Chief Executive Officer Bob Kahn and Vice-President and Chief Financial Officer Steve Byone filed with this Application. Mr. Kahn's testimony includes a copy of the ERCOT Board of Directors resolution authorizing ERCOT's request for approval of the interim Nodal Surcharge.

20. ERCOT requests that the Commission approve a good cause waiver of the requirements of the Nodal Surcharge Fee Filing Package⁵ that cannot feasibly be provided in the unique circumstances of this request. ERCOT will present all of the materials required by the Nodal Surcharge Fee Filing Package when it files for final approval of the Nodal Surcharge.

21. ERCOT requests that, for purposes of interim approval of a revised Nodal Surcharge, the Commission maintain rulings in Docket Nos. 32686 and 35428 not related to the specific level of the Nodal Surcharge, specifically including:

A. "ERCOT will charge the Nodal Surcharge to QSEs representing generation resources, multiplying the surcharge factor ... by the total net metered generation aggregated to the QSE level."⁶

⁵ In ERCOT's prior Nodal Surcharge dockets, the Commission approved a Fee Filing Package that is based on, but distinct from, the Fee Filing Package applicable to ERCOT's System Administration Fee requests. See Docket No. 35428, *Order* at 3, and Docket No. 32686, *Order Nunc Pro Tunc* at 1-2 and *Order Nos. 13 and 14*.

⁶ Docket No. 35428, *Order*, at 8 (FOF 14).

B. The "Commission's order and Order Nunc Pro Tunc in Docket No. 32686 remain in full force and effect."⁷

22. ERCOT files this request for interim relief pursuant to P.U.C. PROC. R. 22.252(b). The Commission's procedures for approval of ERCOT fees and rates provide that any request for interim relief "shall be filed no later than 60 days before the interim relief is proposed to take effect." *Id.* ERCOT requests that the interim Nodal Surcharge requested herein take effect no later than February 1, 2009. This request for interim relief is thus timely filed under the Commission's Rule.

23. ERCOT's application includes a form of the Notice required pursuant to P.U.C. PROC. R. 22.252(d). In addition, ERCOT has provided extensive notice of its request by serving this Request for Interim Relief by electronic mail and U.S. Mail on all parties to ERCOT's most recent System Administration Fee and proceedings related to Nodal Market implementation (Docket Nos. 36345, 35785, 35428, and 32686).

III. CONCLUSION

WHEREFORE, for all the reasons stated, ERCOT respectfully requests that the Commission approve, on an interim basis, ERCOT's request for: (a) a Nodal Surcharge of \$0.38 per MWh, effective no later than February 1, 2009 and terminating upon Commission approval of a final Nodal Surcharge; (b) authorization for recovery of Nodal implementation expenditures from the Nodal Surcharge until the Commission approves a final Nodal implementation schedule, budget, and surcharge level; (c) authorization to defer Nodal debt repayments previously scheduled to begin in 2009; (d) a good cause waiver from the Commission's Fee

⁷ *Id.* at 9 (Ordering Paragraph 2).

Filing Package requirements for Nodal Surcharge requests; and (e) that the Commission affirm its prior rulings regarding the structure and allocation of the Nodal Surcharge.

Respectfully submitted,

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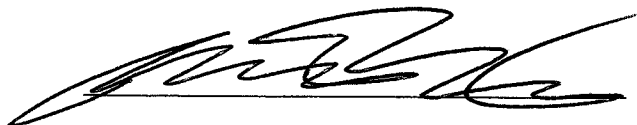
By: 

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MA Bar No. 625380

ATTORNEYS FOR THE ELECTRIC
RELIABILITY COUNCIL OF TEXAS

CERTIFICATE OF SERVICE

I certify that a copy of this document was served on all parties of record in Docket Nos. 32686, 35428, 35785 and 36345 on November 19, 2008, in the following manner: by email or first-class U.S. mailing.



ATTACHMENT A: PROPOSED FORM OF NOTICE

DOCKET NO. _____

ERCOT APPLICATION FOR	§	PUBLIC UTILITY COMMISSION
APPROVAL OF A REVISED NODAL	§	
MARKET IMPLEMENTATION	§	OF TEXAS
SURCHARGE AND REQUEST FOR	§	
INTERIM RELIEF	§	

NOTICE

On November 19, 2008, Electric Reliability Council of Texas, Inc. (ERCOT) filed with the Public Utility Commission of Texas (Commission) its Application for Approval of a Revised Nodal Market Implementation Surcharge (Nodal Surcharge) and Request for Interim Relief. The purpose of the Nodal Surcharge is to fund the personnel, software, equipment, training, and services necessary to develop and implement the Nodal Market called for in the ERCOT Nodal Protocols approved by the Commission. In May 2008, in Docket No. 35428, the Commission approved a Nodal Surcharge in the amount of \$0.169 per megawatt hour (MWh), to be charged to QSEs representing generation resources. The Nodal Surcharge is calculated by multiplying the surcharge factor of \$0.169/MWh by the total net metered generation aggregated to the QSE level. ERCOT requests that it be authorized to increase the Nodal Surcharge, on an interim basis, to \$0.38/MWh, effective no later than February 1, 2009. The interim Nodal Surcharge requested would increase the Nodal Surcharge by \$0.211/MWh. The requested increase in the Nodal Surcharge will enable ERCOT to fund projected Nodal implementation expenses of approximately \$12.0 million per month while the interim Nodal Surcharge is in effect. ERCOT's request for an interim increase in the Nodal Surcharge is premised on its commitment to file a request for a final Nodal Surcharge after adoption by the ERCOT Board of Directors of a revised schedule and budget for completion of Nodal Market implementation. The requested interim Nodal Surcharge would remain in effect only until the Commission approves a final Nodal Surcharge. As the entities paying the Nodal Surcharge, QSEs representing generation resources are most directly affected by the requested change in the Nodal Surcharge. The ERCOT Board of Directors approved ERCOT's filing for an interim revised Nodal Surcharge at its November 17, 2008 meeting.

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The deadline for intervention in the proceeding is _____, 2008.

Persons who wish to intervene in or comment in this proceeding should notify the Public Utility Commission of Texas by the intervention deadline. A request to intervene or for further information should be mailed to the Public Utility Commission of Texas, P.O. Box 13326, Austin, Texas 78711-3326. A request to intervene shall include a statement of position containing a concise statement of the requestor's position on the application, a concise statement of each question of fact, law, or policy that the requestor considers at issue and a concise statement of the requestor's position on each issue identified.

ERCOT has posted this notice and a copy of its Nodal Surcharge Application on its web site at http://www.ercot.com/about/governance/legal_notices.html. Interested parties may also access ERCOT's Application for a Nodal Surcharge through the Public Utility Commission's web site at <http://www.puc.state.tx.us> under Docket No. _____, *ERCOT Application for Approval of a Revised Nodal Market Implementation Surcharge and Request for Interim Relief*.

DIRECT TESTIMONY OF

BOB KAHN

PRESIDENT AND CHIEF EXECUTIVE OFFICER

ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.

IN SUPPORT OF

**ERCOT'S APPLICATION FOR INTERIM APPROVAL
OF A REVISED NODAL MARKET IMPLEMENTATION
SURCHARGE**

1 **DIRECT TESTIMONY OF BOB KAHN**

2

3 **I. POSITION AND QUALIFICATIONS**

4

5 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

6 A. My name is Bob Kahn. My business address is 7620 Metro Center Drive, Austin,
7 Texas 78744.

8

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

10 A. I am employed by the Electric Reliability Council of Texas, Inc. ("ERCOT") as
11 President and Chief Executive Officer ("CEO"). I joined ERCOT in July 2007.

12

13 **Q. PLEASE OUTLINE YOUR EDUCATION AND PROFESSIONAL**
14 **QUALIFICATIONS.**

15 A. Before returning to ERCOT as CEO, I served on the ERCOT Board of Directors
16 from 2002 through 2006, including several terms as Chair of the Board's Human
17 Resources and Governance Committee. Immediately prior to accepting the CEO
18 position, I served as the Deputy General Manager for Austin Energy. In my
19 sixteen (16) years at Austin Energy, I also served as General Counsel and Vice-
20 President for Legal Services for eight years. In that position, and in my prior role
21 as a senior attorney, I was responsible for providing counsel on all electric utility
22 legal, regulatory and legislative matters for Austin Energy. I was involved in the
23 negotiation and drafting of SB 7 on behalf of the public power industry, and have
24 actively participated in the evolution of competitive markets in the ERCOT
25 region.

26 Before joining Austin Energy, I was in private practice in Austin, where I
27 provided advice to municipally owned electric utilities and served as lead counsel
28 in proceedings before this Commission, the Texas Commission on Environmental
29 Quality, and the Texas Railroad Commission. Previous to entering private
30 practice, I was a staff attorney in the Public Utility Commission ("Commission")
31 General Counsel's Office, where I represented the public interest in electric and

1 water utility rate and certification cases. In these various roles, I have been an
2 active participant in the Texas electric industry for over twenty (20) years.

3 Before beginning my career in the electric industry, I served in the United
4 States Air Force as a Judge Advocate, directing administrative hearings and
5 investigations, and represented the Air Force before the Merit Systems Protection
6 Board. I earned my J.D. in 1978 from the University of Dayton School of Law
7 and a bachelor of arts in psychology from Ohio University in 1975.
8

9 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS CHIEF**
10 **EXECUTIVE OFFICER.**

11 A. I am responsible for both the overall operations and strategic direction of ERCOT.
12 I am the ERCOT officer ultimately responsible for carrying out the policies of the
13 ERCOT Board of Directors, as well as policy directives from the Commission and
14 the Texas Legislature. My key responsibilities include ensuring that ERCOT has
15 the physical infrastructure, human resources, and funding necessary for ERCOT
16 to meet the objectives established by legislative and regulatory oversight, and by
17 other governing documents, such as the ERCOT Protocols. In my role as CEO, I
18 also maintain active communications with the various stakeholders and
19 policymakers who have interests in the development of the ERCOT market.
20

21 **Q. WHAT IS YOUR ROLE IN THE TEXAS NODAL MARKET**
22 **IMPLEMENTATION PROGRAM?**

23 A. I was involved in the development of the Texas Nodal Market Implementation
24 Program ("Nodal Program") as an ERCOT Board member, and now, as ERCOT's
25 CEO, have the task of ensuring the Nodal transition is completed successfully.
26 Both as a Board member and as CEO, my objectives regarding delivery of the
27 Nodal Market are the same: (1) to implement the Nodal Protocols on a timely
28 basis to achieve a reliable and efficient Nodal Market in the ERCOT region; (2) to
29 successfully transition the ERCOT organization into the Nodal Market
30 environment when new Nodal Market systems and operations come on line; and
31 (3) to seek every reasonable opportunity to control Nodal Program costs.

1 **Q. HAVE YOU ATTACHED ANY EXHIBITS TO YOUR TESTIMONY?**

2 A. Yes. I have attached two resolutions adopted by the ERCOT Board of Directors
3 on November 17, 2008. Exhibit BK-1 is the resolution authorizing ERCOT to
4 make its filings seeking a revised interim Nodal Surcharge. Exhibit BK-2 is the
5 resolution authorizing additional spending on the Nodal Program through
6 February 28, 2009.

7
8 **Q. PLEASE DESCRIBE THE CHANGES IN THE NODAL**
9 **IMPLEMENTATION SCHEDULE SINCE THE COMMISSION LAST**
10 **APPROVED THE NODAL SURCHARGE IN DOCKET NO. 35428.¹**

11 A. In May 2008, ERCOT determined that it could not feasibly deliver the Nodal
12 market by the scheduled Go Live deadline of January 1, 2009. ERCOT will not
13 be in a position to complete program requirements by that date due to several
14 factors, including key vendor software delays, higher data volumes than initially
15 anticipated, increased testing needs to resolve defects, incorporation of new
16 Protocols to resolve market defects, and the project being much more complex
17 than anticipated. Due to the necessary sequencing of events in building Nodal
18 Market systems, the delay in certain key components had a cascading effect that
19 held up progress in the overall program.

20
21 **Q. HOW IS ERCOT DETERMINING A NEW SCHEDULE FOR THE**
22 **COMPLETION OF NODAL IMPLEMENTATION?**

23 A. After ERCOT management concluded that the original Nodal Go Live date was
24 impracticable, we carefully examined the entire Nodal Program organization to
25 determine how to keep Nodal implementation moving forward at maximum
26 efficiency. ERCOT executives initiated changes in Nodal Program leadership,
27 including the decision to have ERCOT Vice-President and Chief Information
28 Officer ("CIO") Ron Hinsley focus all of his efforts on Nodal implementation. In
29 addition, ERCOT replaced the entity previously responsible for conducting

¹ Docket No. 35428, *Application of ERCOT For Approval of a Revised Nodal Market Implementation Surcharge*.

1 outside audits of Nodal Program audit controls, and retained the utility industry
2 consulting firm Utilicast to conduct future program audits. As discussed in more
3 detail herein, Utilicast will also bring its expertise to bear on the work of the
4 "Special Nodal Program Committee" appointed recently by the ERCOT Board of
5 Directors.

6 ERCOT is conducting a comprehensive review of the Nodal Program led
7 by ERCOT CIO Ron Hinsley and involving ERCOT personnel and vendors. We
8 instructed all Nodal Program personnel and vendors to scrutinize the delivery
9 dates, budgets, and integration implications of their parts of Nodal
10 implementation. This review will ultimately support a fully integrated Nodal
11 implementation schedule and budget. In this review process, ERCOT is
12 uncovering shortcomings in previous planning and integration efforts that we
13 believe must be corrected for the Nodal Program to move forward successfully.
14 As such shortcomings are identified, Nodal Program leadership is devising ways
15 to correct them and integrate the new solutions in the forward-looking schedule
16 and budget.

17
18 **Q. HAS ERCOT'S PROGRAM REVIEW RESULTED IN CONCRETE**
19 **CHANGES IN THE NODAL PROGRAM ORGANIZATION?**

20 **A.** Yes. Since the announcement of the delay in the Go Live date in May, the Nodal
21 Program structure has changed in significant ways based on ERCOT's internal
22 program review. These changes include:

- 23 • Development of integrated scheduling tools that will be used for
24 measuring progress and focusing on activities that affect the critical path;
25
- 26 • Reorganization of programs into core projects having accountability for all
27 aspects of project delivery;
28
- 29 • Rebuilding the project management office with a structure and the skills
30 needed to support a program of the size and complexity of the Nodal
31 Program;
32
- 33 • Creation of jointly-defined formal releases across Nodal Program teams;
34
- 35 • Addition of time for testing in the lower environments; and

- 1 • Improved vendor management procedures.
2

3 **Q. HAS THE ERCOT BOARD OF DIRECTORS ESTABLISHED**
4 **ADDITIONAL OVERSIGHT RELATED TO THE NODAL SCHEDULE**
5 **AND BUDGET?**

6 A. Yes. The ERCOT Board of Directors created a special committee, the “Special
7 Nodal Program Committee,” to provide Director-level recommendations and
8 oversight for the remaining efforts of the Nodal Program. The Special Nodal
9 Program Committee is already active, and will play an important role in the
10 review and approval of a new completion schedule and budget for the Nodal
11 Program. The Special Committee will work closely with Utilicast to review the
12 Nodal Program budget and schedule before it is presented for approval to the
13 ERCOT Board of Directors.

14
15 **Q. ARE THERE DEVELOPMENTS OUTSIDE THE ERCOT**
16 **ORGANIZATION AFFECTING COMPLETION OF THE NODAL**
17 **IMPLEMENTATION SCHEDULE?**

18 A. Yes. At its Open Meeting on September 11, 2008, the Commission decided to
19 revisit the Cost-Benefit Analysis (“CBA”) supporting the transition to a Nodal
20 Market in the ERCOT region. At the direction of the Commission, ERCOT staff
21 is working with Commission staff and consultants from Charles River Associates
22 to develop the CBA. The expected date of the delivery of the CBA to the
23 Commission is December 15, 2008.

24 The Commission requested that, during the preparation of the CBA,
25 ERCOT continue working on Nodal implementation, but that ERCOT refrain
26 from moving forward with a new completion schedule and budget. If the
27 Commission determines that certain aspects of Nodal implementation should be
28 revisited based on the CBA analysis, those determinations will need to be taken
29 into account in the final program schedule and budget. The Commission’s
30 conclusions after reviewing the CBA will therefore provide a major input in
31 ERCOT’s schedule and budget planning process.

1 **Q. WHAT ARE THE STEPS IN THE REVIEW AND APPROVAL PROCESS**
2 **FOR THE FORTHCOMING ERCOT SCHEDULE AND BUDGET?**

3 A. The Nodal Program leadership is completing work on an integrated schedule and
4 budget that assumes the scope of the Nodal implementation is still driven by the
5 approved Nodal Protocols. When ERCOT receives feedback from the
6 Commission based on analysis of the CBA, Nodal Program leadership will need
7 to assess whether the Commission's directions require changes to the schedule
8 and budget before they are presented for approval (unless the CBA calls on
9 ERCOT to discontinue or substantially modify its Nodal implementation efforts).

10 After ERCOT staff include any changes required by the CBA, they will
11 submit the schedule and budget for review by two standing stakeholder groups:
12 the Transition Plan Task Force ("TPTF") and the Technical Advisory Committee
13 ("TAC"). The budget and schedule emerging from the TPTF and TAC review
14 will then be vetted by the Board of Directors' Special Nodal Program Committee,
15 which will work closely with consultants from Utilicast. The Special Nodal
16 Program Committee will then make a recommendation on the schedule and
17 budget to the full ERCOT Board of Directors.

18 The schedule and budget approved by ERCOT's Board of Directors will
19 provide the basis for ERCOT's filing at the Commission seeking a final Nodal
20 Surcharge to replace the interim surcharge requested in this proceeding.

21

22 **Q. HAS ERCOT REQUESTED THAT THE COMMISSION EXTEND THE**
23 **DEADLINE IT ESTABLISHED FOR COMPLETING NODAL MARKET**
24 **IMPLEMENTATION?**

25 A. Yes. ERCOT filed its request in Docket No. 36345, *ERCOT Request for Interim*
26 *Relief Regarding Ordering Paragraph No.2 of the Final Order in Docket No.*
27 *31540 Approving Nodal Protocols*. In that docket, ERCOT requested that the
28 Commission grant interim relief from the requirement that ERCOT complete
29 Nodal implementation by January 1, 2009. ERCOT further requested that the
30 Commission consider a new implementation date, along with a final Nodal

1 Surcharge, after the completion of the schedule and budget review and approval
2 process discussed above.

3
4 **Q. WHAT IMPACT HAS THE EXTENSION OF THE NODAL**
5 **COMPLETION DATE HAD ON THE COST OF NODAL**
6 **IMPLEMENTATION?**

7 A. As discussed above, ERCOT Nodal Program personnel will not be able to put
8 forward specific budget data until the completion of the Commission's CBA
9 review. In general, however, the most obvious impact of the later completion date
10 is that it necessarily increases the cost of completing the Nodal implementation.

11
12 **Q. WHY IS THAT THE CASE?**

13 A. ERCOT's previous budgets for the Nodal Program assumed project completion
14 by January 1, 2009. Based on that assumption, the Nodal Program budget did not
15 anticipate ERCOT incurring new Nodal implementation expenses after year end
16 2008. Due to the delay in completion of Nodal implementation, ERCOT will
17 continue to incur Nodal Program costs into the 2009 budget year. In addition, the
18 bulk of the ongoing costs of Nodal implementation are related to human
19 resources. The ERCOT staff, vendor personnel, and specialized consultants who
20 are essential to keeping Nodal implementation on track must stay at work and be
21 funded for the Nodal Program to have any chance of success. The personnel
22 expenses vary over the life of the Nodal Program, but generally remain fairly
23 constant; as personnel working on one major aspect of the project roll off it, they
24 are replaced by the personnel working on the next major part.

25
26 **Q. WHAT ARE THE CONSEQUENCES OF THE INCREASED COSTS ON**
27 **ERCOT'S ABILITY TO FUND THE NODAL PROGRAM?**

28 A. Because the Nodal Program's prior budget did not contemplate the program
29 extending beyond year end 2008, and program spending has been running at or
30 above expected levels, ERCOT is nearing the limit of the Nodal implementation
31 expenditures approved by the ERCOT Board of Directors. Similarly, ERCOT is

1 near the limit of the Commission-approved amount that may be funded from the
2 Nodal Surcharge. As discussed in the testimony of ERCOT Vice-President and
3 Chief Financial Officer Steve Byone, ERCOT projects that the Nodal Program
4 will reach its authorized spending limit during the month of January 2009. In
5 order to complete Nodal implementation as it is contemplated in the Nodal
6 Protocols, ERCOT must obtain additional authority from the Commission to fund
7 Nodal Program expenditures from the Nodal Surcharge.
8

9 **Q. HOW DOES ERCOT PROPOSE TO FUND THE NODAL PROGRAM**
10 **PRIOR TO COMPLETION OF A FINAL SCHEDULE AND BUDGET?**

11 A. ERCOT requests that the Commission approve, on an interim basis, a revised
12 Nodal Surcharge that enables ERCOT to fund the Nodal Program's expenditures
13 on a month-to-month basis, beginning on February 1, 2009. With the interim
14 Nodal Surcharge in place, ERCOT will be in a position to maintain Nodal
15 Program operations during the review and approval process of its new schedule
16 and budget. Once the schedule and budget are approved by the ERCOT Board of
17 Directors, ERCOT will return to the Commission to seek approval of a final
18 schedule and a Nodal Surcharge based on the Board-approved budget.
19

20 **Q. FOR WHAT PERIOD DOES ERCOT PROPOSE THE INTERIM NODAL**
21 **SURCHARGE REMAIN IN EFFECT?**

22 A. ERCOT requests that the interim Nodal Surcharge become effective no later than
23 February 1, 2009 so that it can be billed for the first time on that date. The end
24 date of the interim Nodal Surcharge would depend on when the Commission
25 completes the proceeding to set the final Nodal Surcharge.
26

27 **Q. WHAT DOES IT COST TO KEEP THE NODAL PROGRAM MOVING**
28 **FORWARD DURING THE DEVELOPMENT AND APPROVAL OF THE**
29 **NEW SCHEDULE AND BUDGET?**

30 A. During 2007 and 2008, the average monthly spending on Nodal development was
31 approximately \$12.0 million. Based on the work that remains to be done to

1 complete Nodal implementation, and assuming the Commission determines that
2 ERCOT should complete Nodal implementation using the existing project scope,
3 ERCOT estimates that the Nodal Program is at its highest expected spending rate
4 between now and June 2009. Nodal Program spending will be carefully
5 scrutinized as part of the review processes already underway by ERCOT staff,
6 standing market committees, and the Board of Directors' Special Nodal Program
7 Committee. At its November 17, 2008 meeting, the ERCOT Board of Directors
8 approved funding authority for the Nodal Program through February 28, 2009 that
9 permits additional Nodal Program spending up to a limit of \$44 million. The
10 Board of Directors will consider additional spending levels prior to the expiration
11 of the spending authority approved to date.
12

13 **Q. WHAT NODAL SURCHARGE LEVEL DOES ERCOT PROPOSE TO**
14 **RECOVER THESE COSTS?**

15 A. ERCOT requests that the Commission approve an interim Nodal Surcharge of
16 \$0.38 per MWh.
17

18 **Q. WHY DID ERCOT CHOOSE \$0.38 PER MWH AS THE INTERIM**
19 **SURCHARGE LEVEL?**

20 A. The ERCOT Board of Directors approved the \$0.38 per MWh Nodal Surcharge
21 rate at its November 17, 2008 meeting. The \$0.38 per MWh level is intended to
22 recover seventy-five percent (75%) of the Nodal Program projected average
23 monthly spending from revenue, with the remaining twenty-five percent (25%)
24 recovered from debt financing. The details of the financial reasoning supporting
25 the proposed surcharge level are included in Mr. Byone's testimony. As ERCOT
26 CEO, I will note that financial prudence dictates that ERCOT minimize its
27 reliance on debt financing of the Nodal Program. ERCOT's debt exposure for
28 Nodal implementation is already approximately \$200 million, and ERCOT is
29 concerned about incurring more debt to finance Nodal implementation. In
30 addition, as detailed in Mr. Byone's testimony, the distress in the financial

000022

1 markets makes credit much more expensive and difficult to obtain than it was
2 when the Nodal Surcharge was set previously.

3 The ERCOT executive team has worked closely with its Board of
4 Directors and with the Commission to keep ERCOT from overextending itself
5 financially. These steps are vital to protecting ERCOT from damaging its ability
6 to execute its core mission of ensuring system reliability and facilitating market
7 transactions. The interim Nodal Surcharge level approved by the ERCOT Board
8 of Directors is consistent with this financially prudent approach.

9
10 **Q. DO YOUR CONCERNS ABOUT PROTECTING ERCOT'S FINANCIAL**
11 **POSITION INVOLVE ISSUES BEYOND THE NODAL PROGRAM?**

12 A. Yes. The Nodal transition represents the largest and most complex single project
13 ERCOT has undertaken, more so even than the retail market opening. Based on
14 my industry experience and on discussions with other ISOs, I believe the Nodal
15 transition is also one of the most complex projects taken on by any ISO in the
16 country. As extraordinary as the Nodal Program is, however, ERCOT must
17 maintain – and continue to improve – its other functions during and after the
18 Nodal transition. In order for ERCOT as an organization to successfully
19 transition to a Nodal environment, ERCOT must manage the transition prudently
20 from a financial and organizational standpoint. Our efforts to achieve the
21 completion of the Nodal Market cannot overshadow the need to make certain
22 ERCOT is in a good position to carry out its myriad duties during the transition
23 and after Nodal goes live.

24
25 **Q. HOW WILL THE PROPOSED INTERIM NODAL SURCHARGE**
26 **AFFECT THE REVENUE/DEBT BALANCE FOR FINANCING NODAL?**

27 A. At present, approximately 28% of Nodal Program expenses have been recovered
28 from revenue (*i.e.*, from the Nodal Surcharge). The remaining 72% of expenses
29 to date have been debt financed. The interim Nodal Surcharge will enable
30 ERCOT to fund 75% of ongoing Nodal operations from revenue, thus enabling
31 ERCOT to minimize the need to draw on additional debt funding during the

1 period prior to approval of the final Nodal implementation schedule and budget
2 and the final Nodal Surcharge. The issues of revenue and debt financing are
3 discussed in more detail in Mr. Byone's testimony.
4

5 **Q. HAS ERCOT CONSIDERED OTHER ALTERNATIVES BESIDES**
6 **INCREASING THE NODAL SURCHARGE AS PROPOSED?**

7 A. Yes. Without additional funding authorization, ERCOT would be forced to halt
8 work on the Nodal Program at the end of January 2009. Alternatively, ERCOT
9 could hold off on its existing work and seek another option apart from full
10 implementation of the Nodal Protocols. If the Commission determines it is in the
11 public interest for ERCOT to investigate other alternatives, ERCOT will do so,
12 but we must have a reliable funding source for the financial obligations that
13 ERCOT incurs in the meantime. If the objective is to move forward on full
14 implementation of the Nodal Protocols, however, ERCOT believes that the
15 proposal before the Commission best balances the need to protect ERCOT's
16 financial integrity with the need for continued expenditures on the Nodal
17 implementation project. The ERCOT Board of Directors considered a number of
18 alternatives to the \$0.38 per MWh surcharge level, and determined that the
19 proposed interim surcharge is the most reasonable approach to providing for the
20 Nodal Program's interim funding needs.
21

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

23 A. Yes.



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

WHEREAS, staff of Electric Reliability Council of Texas, Inc. (ERCOT) has requested that the Board of Directors (Board) authorize continued spending of up to \$44 million so that the development of the Texas Nodal Market Implementation Program (Nodal Program) can move forward through February 2009;

WHEREAS, the Public Utility Commission of Texas (PUCT) has asked ERCOT to refrain from moving forward with a revised schedule and budget until the PUCT completes and reviews an updated Cost-Benefit Analysis (CBA) of the decision to move to Nodal operations;

WHEREAS, ERCOT will prepare a final budget and schedule for the Nodal Program, including a request for authority to spend amounts in addition to the interim budget authority approved by the ERCOT Board of Directors after review of the CBA; and

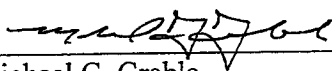
WHEREAS, continued funding of the Nodal Program requires ERCOT to increase the existing nodal surcharge approved by the PUCT;

NOW, THEREFORE, BE IT RESOLVED, that ERCOT is authorized to make a regulatory filing with the PUCT seeking: (a) a change in the Nodal Surcharge rate from \$0.169 per megawatt-hour (MWh) to \$0.38 per MWh, effective no later than February 1, 2009, which represents a 75% revenue contribution to new Nodal Program spending; and (b) a deferral of Nodal debt repayment beginning in 2009 as contemplated in the most recent surcharge filing with the PUCT.

CORPORATE SECRETARY'S CERTIFICATE

I, Michael G. Grable, Corporate Secretary of ERCOT, do hereby certify that, at its November 17, 2008 meeting, the ERCOT Board of Directors passed a motion approving the above Resolution by a vote of ten in favor, four opposed (Messrs. Cox, Helton, Jenkins and Wilkerson), and one abstention (Mr. Kahn).

IN WITNESS WHEREOF, I have hereunto set my hand this 17th day of November, 2008.



Michael G. Grable
Corporate Secretary



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

WHEREAS, Electric Reliability Council of Texas, Inc. (ERCOT) will exceed the existing Board-approved budget for the Texas Nodal Market Implementation Program (Nodal Program) of \$319.5 million in or around December 2008; and

WHEREAS, the Nodal Program will not be complete as originally expected by January 1, 2009; and

WHEREAS, the Public Utility Commission of Texas (PUCT) has asked ERCOT to refrain from moving forward with a revised schedule and budget until the PUCT completes and reviews an updated Cost-Benefit Analysis (CBA) of the decision to move to Nodal operations; and

WHEREAS, without additional interim budget authority ERCOT will not be able to keep operating the Nodal Program; and

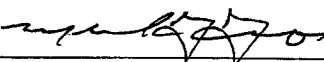
WHEREAS, ERCOT will prepare a final budget and schedule for the Nodal Program, including a request for authority to spend amounts in addition to the interim budget authority approved herein after review of the CBA;

NOW, THEREFORE, BE IT RESOLVED, that ERCOT is authorized to spend up to \$44 million on the Nodal Program through February 28, 2009, in addition to the currently approved \$319.5 million Nodal Program budget, increasing the Board-approved budget for the Nodal Program to a maximum of \$363.5 million. After February 28, 2009, ERCOT may continue spending funds on the Nodal Program only with further authorization from the ERCOT Board of Directors.

CORPORATE SECRETARY'S CERTIFICATE

I, Michael G. Grable, Corporate Secretary of ERCOT, do hereby certify that, at its November 17, 2008 meeting, the ERCOT Board of Directors passed a motion approving the above Resolution by a vote of 14 in favor and one opposed (Mr. Patton).

IN WITNESS WHEREOF, I have hereunto set my hand this 17th day of November, 2008.



Michael G. Grable
Corporate Secretary

DIRECT TESTIMONY OF

STEVE BYONE

VICE-PRESIDENT AND CHIEF FINANCIAL OFFICER

ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.

IN SUPPORT OF

**ERCOT'S APPLICATION FOR INTERIM APPROVAL
OF A REVISED NODAL MARKET IMPLEMENTATION
SURCHARGE**

1 **DIRECT TESTIMONY OF STEVE BYONE**

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

4 A. My name is Steve Byone. My business address is 7620 Metro Center Drive,
5 Austin, Texas 78744.
6

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

8 A. I am employed by the Electric Reliability Council of Texas, Inc. ("ERCOT") as
9 Vice-President and Chief Financial Officer ("CFO"). I began my employment at
10 ERCOT in 2005. I was appointed to my current position in September 2005.
11

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

14 A. I am responsible for all treasury functions including financing, cash management,
15 and credit analysis. I also oversee all accounting operations including accounts
16 receivable, accounts payable, fixed assets, financial reporting, and
17 budgeting/forecasting. Additionally, I oversee the company's procurement, (non-
18 Nodal) Project Management Office, and enterprise risk management functions.
19 Finally, I am responsible for management of the \$100 million-plus corporate
20 operating budget and I am the primary liaison between the Finance and Audit
21 Committee of the Board of Directors and ERCOT.
22

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

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

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

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

18 A. Yes, I testified in Docket 31824 (ERCOT's 2006 System Administration fee case)
19 and Docket Nos. 32686 and 35428 (ERCOT's requests for approval of the Nodal
20 Program surcharge).

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

23 A. The purpose of my testimony is to provide support for ERCOT's request for
24 interim approval to revise the Nodal Surcharge to \$0.38 per MWh. ERCOT
25 requests that the interim Nodal Surcharge become effective February 1, 2009 and
26 remain in effect until the Commission's approval of a final revised Nodal
27 Surcharge.

28
29 **Q. PLEASE EXPLAIN HOW ERCOT HAS BEEN FUNDING THE TEXAS**
30 **NODAL MARKET IMPLEMENTATION PROGRAM.**

1 A. ERCOT is funding the Texas Nodal Market Implementation Program ("TNMIP"
2 or "Nodal Program") by means of a special purpose surcharge approved by the
3 Commission in Docket Nos. 32686 and 35428 (the "Nodal Surcharge"). The
4 approved Nodal Surcharge is scheduled to be collected until ERCOT recovers the
5 costs of implementing the Nodal Market, including the repayment of debt
6 associated with Nodal implementation. The Nodal Surcharge was originally
7 estimated to continue through 2012. In Docket No. 35428, the Commission
8 approved a Settlement Agreement supporting approval of ERCOT's proposed
9 Nodal Surcharge amount of \$0.169 per MWh.

10

11 **Q. WHAT WERE THE KEY ASSUMPTIONS UNDERLYING ERCOT'S**
12 **REQUEST FOR THE \$0.169 PER MWH NODAL SURCHARGE?**

13 A. When the Commission approved the \$0.169 per MWh surcharge in Docket No.
14 35428, the Nodal Surcharge level was based on certain key assumptions which
15 included:

16

17 • Nodal implementation efforts funded by the Nodal Surcharge would
18 terminate as of January 1, 2009 (assuming a December 2008 Go Live
19 date), and "Nodal" operations would be funded as part of ERCOT
20 operations after the Go Live date.

21

22 • The total Nodal Program costs recoverable through the Nodal Surcharge
23 (including debt service interest costs) would be approximately \$311.3
24 million.

25

26 • Debt financing terms would not be dramatically different from those
27 available when the Nodal Program began. Interest rates of 5.5 percent
28 were assumed for 2006 borrowings and 6.0 percent after 2006.

29

30 • It would be financially prudent for ERCOT to fund 27.4 percent of Nodal
31 Program costs during development (*i.e.*, on a "pay as you go" revenue
32 basis while the Nodal Market was being implemented) and the remainder
33 with debt financing.

34

35 **Q. HAVE ANY OF THE ASSUMPTIONS SUPPORTING THE \$0.169 NODAL**
36 **SURCHARGE CHANGED SINCE THE COMMISSION APPROVED IT?**

1 A. Yes. In fact, all of the major assumptions I identified above have changed since
2 the Commission approved the current Nodal Surcharge. First, as discussed in the
3 testimony of ERCOT President and Chief Executive Officer Bob Kahn, the Go
4 Live date for the Nodal Market has been delayed. Second, the costs of Nodal
5 implementation will exceed the amount projected when the Commission approved
6 the Nodal Surcharge. Third, conditions in the credit markets are dramatically
7 different from what they were when the current Nodal Surcharge was approved.
8 Fourth, ERCOT's previous ability to place a heavy reliance on debt to fund the
9 bulk of the Nodal Program has changed due to the current debt level on ERCOT's
10 balance sheet and the increased debt levels that would result from continued
11 heavy reliance on debt to fund further costs.

12

13 **Q. WHAT IMPACT DOES THE DELAY IN THE GO LIVE DATE HAVE ON**
14 **NODAL COSTS AND FINANCING CONSIDERATIONS?**

15 A. The Commission approved the Nodal Surcharge as a way to fund the development
16 and implementation of the Nodal Market. If the January 1, 2009 Go Live
17 deadline had been achieved, the development and implementation costs to be
18 funded by the Nodal Surcharge would have ceased when the Nodal Market
19 opened at the end of 2008. There would have been a clear end date on which to
20 base an accounting of the costs of the Nodal Program and the repayment of the
21 debt associated with it. The delay in the completion of Nodal implementation
22 means that the Nodal Program will continue to incur substantial costs beyond
23 those that were included in the estimates that formed the basis for the Nodal
24 Surcharge. In addition, we had originally anticipated beginning to pay down debt
25 in 2009. Given the ongoing development on the project, ERCOT anticipates the
26 need to defer repayment of debt.

27

28 **Q. WHAT IS THE IMPACT OF NODAL COSTS EXCEEDING THE**
29 **PREVIOUS ESTIMATE OF THE AMOUNT RECOVERABLE FROM**
30 **THE \$0.169 PER MWH SURCHARGE?**

1 A. There are two ramifications of the higher than anticipated costs of Nodal
2 implementation. First, ERCOT must receive the necessary approvals to increase
3 Nodal Program expenditures. ERCOT's spending on the Nodal Program is
4 limited by controls imposed by both ERCOT's Board of Directors and the
5 Commission. At the time the current Nodal Surcharge was approved, the ERCOT
6 Board of Directors had authorized ERCOT to spend a total of \$319.5 million on
7 Nodal implementation. The Commission approved the Nodal Surcharge at a level
8 sufficient "to recover from the Nodal Surcharge \$311.3 million of the estimated
9 costs of implementing the Nodal Market."¹ The Commission provided that
10 ERCOT could initiate proceedings to change the Nodal Surcharge "only if the
11 change in the Nodal Program cost estimate leading to the request is more than 10
12 percent higher or lower than the amounts presented in this proceeding."² ERCOT
13 received additional budget authority for the Nodal Program from its Board of
14 Directors at their November 17, 2008 meeting. The Board of Directors authorized
15 an additional \$44 million of spending through February 28, 2009.

16 Second, ERCOT must determine the method for funding these additional
17 costs. Along with providing additional budget authority for the Nodal Program,
18 the ERCOT Board of Directors also authorized ERCOT to make its filing with the
19 Commission requesting interim authority to revise the Nodal Surcharge to \$0.38
20 per MWh.

21
22 **Q. WHAT FACTORS DID ERCOT CONSIDER WHEN DETERMINING**
23 **THE AMOUNT OF SURCHARGE TO REQUEST?**

24 A. The increased costs associated with completing the Nodal Market require ERCOT
25 to review the impact that continuing to fund Nodal implementation primarily with
26 debt is having on ERCOT's overall financial health. There are a number of
27 considerations ERCOT must examine in this regard. First, ERCOT must
28 cautiously manage its current debt load. ERCOT has already borrowed nearly

¹ Docket No. 35428, *Application of Electric Reliability Council of Texas For Approval of a Revised Nodal Market Implementation Surcharge*, Order at 7 (FOF 5) (May 13, 2008).

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

1 \$200 million to fund Nodal Program costs in addition to borrowings to fund other
2 capital expenditures. Second, ERCOT needs to preserve some level of borrowing
3 capacity for other planned projects as well as for unexpected future needs.
4 Maintaining a source of available credit to address potential future borrowing
5 needs for unexpected events is prudent. Third, increased debt funding for the
6 Nodal Program adds significantly to overall Nodal implementation cost due to
7 increased interest expense. That is, the combination of higher Nodal Program
8 debt levels together with recent increases in borrowing costs add to the overall
9 costs of the program.
10

11 **Q. HOW DOES THE CURRENT UNCERTAINTY REGARDING THE**
12 **NODAL SCHEDULE AND BUDGET AFFECT ERCOT'S ABILITY TO**
13 **FUND ONGOING NODAL DEVELOPMENT COSTS WITH DEBT?**

14 A. As discussed in detail in Mr. Kahn's testimony, there will not be a final schedule
15 and budget for the Nodal Program until after the Commission's review of its
16 Nodal Cost Benefit Analysis ("CBA") and the review and vetting of the proposed
17 budget and schedule by ERCOT committees, consultants from Utilicast, and the
18 ERCOT Board of Directors. I certainly do not disagree with the need for
19 thoughtful consideration of the schedule and budget, but the timing unavoidably
20 creates uncertainty regarding both the expected total cost to complete the Nodal
21 Program as well as the time frame over which funding must be available. This
22 uncertainty makes it difficult for ERCOT to obtain substantial additional debt
23 financing for the Nodal Program. Even in the best of times, lenders expect
24 specifics regarding the amount to be borrowed, sources of cash to facilitate
25 repayment, and the timeline for the repayment plan. In the current circumstances,
26 ERCOT is not able to provide such certainty regarding the funding needs for the
27 Nodal Program.
28

29 **Q. WHAT IMPACT HAS THE DETERIORATION OF THE CREDIT**
30 **MARKETS HAD ON ERCOT'S ABILITY TO CONTINUE FUNDING**
31 **NODAL DEVELOPMENT COSTS WITH DEBT?**

1 A. Financial markets worldwide are undergoing a period of unprecedented turmoil.
2 The credit crunch is affecting businesses, governments, and other institutions of
3 all sizes. When ERCOT seeks credit in today's market environment, it must
4 consider the following factors:

- 5
6 • Banks are being forced to properly reflect the impact of troubled loans and
7 therefore in many cases have less capital available for lending.
8
- 9 • Many borrowers who previously tapped into auction-rate debt and
10 commercial paper are no longer able to borrow in this fashion. These
11 borrowers are seeking bank loans as replacements for those facilities
12 which are no longer available, which consumes bank credit capacity that
13 was previously available in the market.
14
- 15 • Given the failure of large banking institutions that had been presumed to
16 be financially sound, banks are nervous and uncertain about which bank
17 might fail next. As a result, banks have been reluctant to lend to one
18 another. This development further constrains credit availability.
19
- 20 • Borrowers with "committed" lines from banks have in many cases drawn
21 down these facilities -- demonstrating a preference to hold cash just in
22 case something happens to the bank.
23
- 24 • Banks which do have capital to lend are preserving the limited capital for
25 their "choice" customers. Moreover, if the banks do lend, they are
26 charging more for it.
27
- 28 • In many instances other investors from whom ERCOT might seek
29 financing are either standing on the sidelines waiting for things to clear, or
30 are indicating that credit will only be provided under much more onerous
31 terms.
32

33 Having recently completed two financings, I believe that ERCOT could still
34 obtain debt financing to fund a reasonable percentage of Nodal costs; however, it
35 is difficult at this time to determine the rate ERCOT might have to pay. ERCOT
36 would ultimately pay a market rate, which while reasonable at issue, may not
37 appear reasonable when viewed over a historical period of time. These
38 considerations certainly affect ERCOT's judgment about the amount of additional
39 debt to devote to funding the Nodal Program.

1 **Q. PLEASE EXPLAIN HOW THE CHANGED CIRCUMSTANCES YOU**
2 **HAVE DESCRIBED AFFECT ERCOT'S VIEW OF THE PRUDENCE OF**
3 **CONTINUING TO FUND NODAL AT THE EXISTING RATIO OF**
4 **REVENUE TO DEBT.**

5 **A.** Thus far, the revenue contribution to Nodal Program funding accounts for only 28
6 percent, with the remaining expenditures being funded through debt. I believe it
7 is critical that the Nodal Program's prospective expenditures be recovered with a
8 much greater emphasis on "pay as you go" revenue funding. ERCOT has already
9 borrowed approximately \$200 million to fund the Nodal Program and when
10 combined with other required borrowing is carrying a debt load of approximately
11 \$350 million. The incremental \$200 million resulting from the Nodal Program
12 was a manageable debt load based on the assumptions underlying the original
13 Nodal Program funding plan. Most importantly, the \$200 million debt funding
14 for the Nodal Program represented a "peak" with the expectation that this debt
15 load would quickly be extinguished, thus freeing up ERCOT's balance sheet. It is
16 important to remember, however, that Nodal Market implementation is not the
17 only ERCOT project that may call for additional debt financing. On the horizon,
18 but not yet fully quantified, are financial needs related to updating ERCOT's
19 operations and data centers, a technology infrastructure refresh, and undertaking
20 responsibilities in new areas such as advanced metering. Moreover, there are
21 always unanticipated needs that require ERCOT to call on credit facilities to meet
22 critical institutional needs. If the Nodal Program absorbs a disproportionate share
23 of ERCOT's debt capacity, ERCOT's financial capabilities may be unduly
24 constrained when they are needed most. Moreover, the concerns expressed by the
25 Commission, ERCOT Board and other stakeholders regarding the amount of debt
26 carried by ERCOT inform our thinking about incurring new debt for any reason.
27 These considerations were significant factors supporting the ERCOT Board of
28 Directors' decision to approve ERCOT's request to increase the revenue share of
29 the funding of the Nodal Program.

30

1 **Q. WHAT IS ERCOT'S RECOMMENDATION FOR THE INTERIM NODAL**
2 **SURCHARGE?**

3 A. ERCOT recommends an interim Nodal Surcharge of \$0.38 per MWh. If the
4 Commission grants ERCOT's request, the Nodal Surcharge would remain at the
5 interim level until Commission approval of a final surcharge (after review of
6 ERCOT's revised schedule and budget for completing Nodal implementation).

7

8 **Q. DOES THE PROPOSED INTERIM NODAL SURCHARGE INCREASE**
9 **THE PROPORTION OF REVENUE FUNDING FOR THE NODAL**
10 **PROGRAM?**

11 A. Yes. The Nodal Surcharge is expected to fund 75 percent of prospective Nodal
12 expenditures until the Commission approves a final Nodal Surcharge. Given that
13 the revenue contribution for the Nodal Program to date is about 28 percent, the
14 overall revenue contribution prior to Go Live will ultimately fall between 28
15 percent and 75 percent of program costs.

16

17 **Q. DOES ERCOT SUPPORT MAINTAINING THIS SURCHARGE LEVEL**
18 **ON A PERMANENT BASIS?**

19 A. As part of the Commission proceeding to set the final Nodal Surcharge, ERCOT
20 may recommend a different surcharge level. ERCOT's position at that time
21 depends on numerous circumstances, such as the final approved schedule and
22 budget amount, the extent to which the Commission's CBA review affects the
23 scope of the Nodal Program, and the state of the credit markets when ERCOT
24 comes before the Commission for final surcharge approval.

25

26 **Q. HOW DID ERCOT DERIVE THE PROPOSED SURCHARGE?**

27 A. In determining how to continue funding the Nodal Program after January 2009
28 (when ERCOT expects to reach the limits of prior spending authorizations),
29 ERCOT examined the best ways to: (a) keep Nodal Program work on track prior
30 to the completion of the final budget and schedule; and (b) incur a manageable
31 amount of new debt during a period of uncertainty. We concluded that the best

approach is to secure revenue funding to cover 75 percent of the Nodal Program's projected monthly expenditures (the "run rate" for the Nodal Program) and to draw on existing ERCOT credit availability for the remaining 25 percent. Adding new debt now does reduce our ability to respond to unexpected events; however, as credit conditions improve ERCOT will seek to bolster available credit.

Q. WHAT IS THE PROJECTED MONTHLY RUN RATE FOR THE NODAL PROGRAM?

A. The projected monthly run rate used to calculate the Nodal Surcharge is \$12.0 million per month. Mr. Kahn's testimony describes the historical Nodal Program data used to support the \$12.0 million figure.

Q. WHAT SCENARIOS DID ERCOT CONSIDER FOR RECOVERING THE MONTHLY RUN RATE FROM THE NODAL SURCHARGE?

A. Once ERCOT determined that its recommendation would be to fund the \$12.0 million monthly run rate using an interim Nodal Surcharge, the key question became: how much of the prospective expenditures should be funded by revenue from the Nodal Surcharge versus by incurring additional debt. ERCOT considered four scenarios depicted in Figure 1 below:

Figure 1
Nodal Surcharge Scenarios
(\$ thousands)

Estimated Monthly "Run Rate":	\$12,000			
	Revenue Contribution Beginning January 1, 2009			
	<u>100%</u>	<u>75%</u>	<u>66%</u>	<u>50%</u>
Anticipated average monthly needs				
Fund a portion of Nodal costs based on the current "run rate"	12,000	9,000	7,920	6,000
Fund interest costs on outstanding Nodal debt	997	1,087	1,119	1,177
Total to be funded	<u>12,997</u>	<u>10,087</u>	<u>9,039</u>	<u>7,177</u>
Fee per MWh	<u>0.49</u>	<u>0.38</u>	<u>0.34</u>	<u>0.27</u>
Incremental monthly debt incurred (for Nodal)	-	3,000.00	4,080.00	6,000.00

1 After considering the alternatives, the ERCOT Board of Directors determined that
2 it was appropriate to provide a substantial revenue contribution toward
3 prospective development costs and approved funding additional Nodal Program
4 spending with 75 percent revenue, resulting in a total interim Nodal Surcharge of
5 \$0.38 per MWh.
6

7 **Q. WHY HAS ERCOT NOT RECOMMENDED A SIMILAR PROPORTION**
8 **OF REVENUE FUNDING AS IN ITS PRIOR NODAL SURCHARGE**
9 **REQUESTS?**

10 A. As I testified in both previous Nodal Surcharge proceedings (Docket Nos. 32686
11 and 35428), ERCOT has considered numerous options each time it has proposed a
12 surcharge level, including revenue funding levels up to 100 percent revenue.³ In
13 the past cases, ERCOT did not recommend revenue funding options similar to the
14 75 percent recommended in this filing because circumstances were appreciably
15 different than they are today. Whenever it assesses a fee, ERCOT must take into
16 account the impact the fee will have on ERCOT and its ability to perform the
17 tasks assigned to it, the impact on the stakeholders who pay the fees, and the
18 overall program cost resulting from funding programs through revenue or debt.
19 In our prior requests, the balance weighed in favor of a lower fee supported by
20 significant debt funding. While this resulted in a higher overall program cost, it
21 kept the surcharge at a lower level while still maintaining ERCOT's financial
22 health.

23 As I detailed above, most of the major assumptions underlying ERCOT's
24 previous Nodal Surcharge requests have changed substantially. ERCOT is
25 certainly cognizant of the impact the proposed increase in the Nodal Surcharge
26 will have on the entities responsible for paying it, and the size of the requested
27 increase in the interim surcharge was vigorously debated by the members of

³ For example, in Docket No. 35428, my testimony included the following: "Since the inception of the Nodal Program, ERCOT has considered several ways to finance Nodal transition activities, ranging from paying for the entire development cost through a surcharge collected on a pay-as-you-go basis to financing 100 percent of the project development cost with debt and establishing a surcharge to service the debt after program implementation." Docket No. 35428, Direct Testimony of Steve Byone, at 7.

1 ERCOT's Board of Directors. However, ERCOT cannot meet its obligation to
2 serve those entities – and all other Market Participants – if it is financially over-
3 extended.

4
5 **Q. DOES DEVOTING 75 PERCENT OF NODAL SURCHARGE REVENUE**
6 **TO PROSPECTIVE SPENDING AFFECT ERCOT'S PREVIOUS PLANS**
7 **FOR THE USE OF SURCHARGE REVENUES?**

8 A. Yes. When the Nodal Program was scheduled to end by January 1, 2009, Nodal
9 Surcharge revenues to be collected in 2009 and beyond were scheduled to be used
10 to retire debt incurred to complete Nodal implementation. The increase in the
11 Nodal Surcharge proposed in this interim proceeding would fund 75 percent of
12 the incremental monthly expenditures necessary to continue development work on
13 the Nodal Program, but would not provide for ERCOT to begin scheduled
14 retirement of Nodal Program debt expected to be outstanding at December 31,
15 2008 – debt that totals approximately \$200 million based upon the timeframe
16 included in the most recent Nodal Surcharge case. Therefore, ERCOT also is
17 seeking a deferral of repayment of any Nodal Program debt incurred until
18 revenues collected from the surcharge are sufficient to cover current cash outlays
19 and to begin servicing outstanding Nodal Program debt.

20
21 **Q. WHEN WILL ERCOT PRESENT A REVISED NODAL PROGRAM DEBT**
22 **REPAYMENT SCHEDULE TO THE COMMISSION?**

23 A. ERCOT will include such data in its filing for a final Nodal Surcharge. ERCOT
24 will be able to accurately assess debt repayment schedules at that time because an
25 approved Nodal Program schedule and budget will provide the framework for
26 program completion.

27
28 **Q. DID ERCOT FILE WITH ITS INTERIM APPLICATION THE**
29 **MATERIALS INCLUDED IN THE NODAL FEE FILING PACKAGE**

30 A. No, but ERCOT will file the full Nodal Fee Filing Package ("FFP") in the
31 forthcoming case to set a final Nodal Surcharge. In the absence of an approved

1 Nodal Program schedule and budget, ERCOT cannot assemble the materials
2 required by the Nodal FFP. The interim surcharge ERCOT requests in this case is
3 intended to provide a "bridge" to keep the Nodal Program moving forward while
4 the Commission considers the CBA analysis and ERCOT committees and
5 consultants vet the proposed schedule and budget. Because of these unique
6 circumstances, ERCOT cannot feasibly file the materials called for in the Nodal
7 FFP, and respectfully requests the Commission waive those requirements solely
8 for the purpose of this interim proceeding.
9

10 **Q. DID ERCOT CONSIDER RECOMMENDING A REVISION TO THE**
11 **EXISTING ALLOCATION OF THE NODAL SURCHARGE TO QSEs**
12 **REPRESENTING GENERATION?**

13 A. No. ERCOT does not recommend changes in the Nodal Surcharge allocation at
14 this time. In this proceeding ERCOT seeks interim approval of a revised Nodal
15 Surcharge that could be effective by February 1, 2009. We are concerned that if
16 the divisive allocation issue is litigated in this interim proceeding, it will delay
17 interim relief and thus leave ERCOT with no authorized funding source for
18 additional Nodal Program spending. This interim proceeding is premised on
19 ERCOT's commitment to return to the Commission with a final Nodal Surcharge
20 proposal once the Nodal Program schedule and budget are approved. If parties
21 desire to re-litigate the allocation issue, we urge that any action on the issue await
22 the final case and not delay interim relief that ERCOT needs to become effective
23 as soon as legally permissible.
24

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

26 A. Yes, it does.

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