



Date: February 10, 2009
To: Board of Directors
From: Trip Doggett, Senior Vice President and Chief Operating Officer
Subject: Texas Nodal Market Implementation Program Budget and Schedule

Issue for the ERCOT Board of Directors

ERCOT Board of Directors Meeting Date: February 17, 2009

Agenda Item No.: 8c

Issues:

With regard to the Texas Nodal Market Implementation Program (Nodal Program):

- Whether to approve a budget proposed by ERCOT Staff and authorize expenditures to complete the Nodal Program up to a total amount not-to-exceed \$658.7 million, consisting of the following:
 - Direct and indirect costs of \$507.5 million;
 - Contingency funding of \$58.6 million; and
 - Financing costs as determined based on the option selected by the Board at its meeting on February 17, 2009. For purposes of the not-to-exceed amount above, an interest cost estimate of \$92.6 million was assumed. This amount includes interest for both the period during implementation and after the go-live date consistent with Option 2a as identified in materials included with Agenda Item 11a for the Board meeting on February 17, 2009 (this is not an endorsement of Option 2a; Option 2a is simply the assumption that was included in the January 2009 Board materials);
- Whether to grant ERCOT officers the delegated authority to control all expense categories within this Nodal Program budget request with the exception of contingency funding which shall remain exclusively within the Board's authority; and
- Whether to approve a schedule proposed by ERCOT Staff and authorize completion of the Nodal Program by a date no later than December 31, 2010.

Pursuant to Agenda Item 11a for the Board meeting on February 17, 2009, ERCOT Staff will request the Board's authorization for ERCOT Staff to prepare a Nodal Surcharge filing with the Public Utility Commission of Texas (Commission), consistent with the Board's authorization of the Nodal Program budget and schedule, to allow ERCOT to recover the maximum amount of costs incurred as a result of the Nodal Program.

Background/History:

Nodal Program Budget and Schedule

The Commission instructed ERCOT to modify its existing wholesale market structure to implement a nodal design in place of the existing zonal market design. In 2006, ERCOT began work on the Nodal Program once the Nodal Protocols were approved. The Board of Directors approved a budget for the Nodal Program of \$319.5 million to cover development coinciding with the Commission-mandated go-live date of January 1, 2009. With the anticipated delay of go-live beyond January 1, 2009, the program was expected to exceed the approved budget in or around December 2008. On September 11, 2008, the Commission engaged an independent, third-party



consultant to perform a Cost-Benefit Analysis (CBA) of the Commission's original decision to move to a nodal market and authorized ERCOT to continue work on the Nodal Program. After due consideration of alternatives, the Board approved an additional \$44 million on the Nodal Program through February 28, 2009, in addition to the approved \$319.5 million budget, increasing the Board-approved budget for the Nodal Program to a maximum not-to-exceed amount of \$363.5 million. This increased budget authority allowed ERCOT to continue operating the Nodal Program while the Commission completed its review of its requested, updated CBA; however, the Board directed ERCOT not to spend any funds on the Nodal Program without further authorization from the Board. At that time, it also requested that ERCOT Staff prepare a final budget and schedule for the Nodal Program. Since the budget and schedule are intertwined, ERCOT Staff presented a preliminary Nodal Program budget and a preliminary Nodal Program Integrated Project Schedule at the Board's Special Meeting on January 21, 2009. The final versions of these two documents are attached hereto as *Exhibits A* and *B*. They are unchanged from the January 2009 versions, except that financing-cost estimates in *Exhibit A* have been reduced by \$1.3 million.

By way of background, the Nodal budget has gone through several iterations. The first 2006 figure of \$125 million was a preliminary budget to begin the program and to set a basis for establishing an initial regulatory Nodal Surcharge recovery amount. This budget was established before the completion of the Nodal protocols and development of business requirements. A second Nodal budget was established at \$267 million based on the first set of Nodal protocols and completion of the first set of business requirements. The Nodal budget was increased to \$319.5 million to account for new Protocols (baseline 1 and 2) and to cover other new requirements of the program. Finally, the most recent interim Nodal budget was approved to allow the Nodal Program to continue until February 28, 2009, while the Commission received the updated CBA and the ERCOT Staff prepared a final Nodal Program budget and schedule. In January 2009, Utilicast, LLC, an independent third-party consultant engaged to review the Nodal Program budget and schedule, provided its "Nodal Program Oversight Report 8 – New Integrated Schedule and Budget Assessment," attached hereto as *Exhibit C*.

In addition, with regard to the Nodal go-live schedule, the Commission issued the Order in Docket No. 31540, filed on April 5, 2006, requiring ERCOT to implement the Nodal Program by January 1, 2009. In May 2008, ERCOT informed the Board that ERCOT would not be in a position to complete the program requirements by the go-live deadline of January 1, 2009, due to several factors. These factors include more complexity than originally anticipated, key vendor software delays, higher data volumes than initially anticipated resulting in more hardware implementations, increased testing needs to resolve defects and new protocols to resolve market defects. Since May 2008, ERCOT performed a review and restructuring of the Nodal program and built an integrated program schedule for the remaining work. In November 2008, the proposed Nodal Program Integrated Project Schedule identified a new go-live date of December 31, 2010.

With regard to the current request for approval, the Nodal Program budget of a total not-to-exceed amount of \$658.7 million is based on the forecasted expenditures required to complete the tasks in the proposed Nodal Program Integrated Program Schedule and launch the Nodal market by December 31, 2010 and on financing the recovery of approved Nodal Program costs consistent with Option 2a as identified in materials included with Agenda Item 11a for the Board meeting on



February 17, 2009.

Delegation of Authority

ERCOT Staff respectfully requests that the Board delegate authority to ERCOT officers to control all categories of expense within this request with the exception of the contingency funding. Based on the Board's recent comments with regard to contingency funding noted in the Nodal Program budget, this request would expressly and exclusively reserve the Board's authority to grant authorization for use of any such contingency funding.

Key Factors Influencing Issue:

Based on the Board's comments at its Special Meeting on January 21, 2009, ERCOT Staff has taken the financial data contained in the preliminary Nodal Program budget (presented on January 21, 2009, and revised per the discussion above) in *Exhibit A* and provided that same data, detailing expenditure type, in following alternative presentation formats of:

- 1) Budget Costs through the proposed Go-Live date of December 31, 2010;
- 2) Nodal Surcharge Cost Recovery, which estimates the amount to be recovered through the Nodal surcharge and which would be the general method of calculation for any regulatory filing with the Commission; and
- 3) Financial Statement Presentation, with the separation of Capital Costs versus Operating Costs.

Schedule of Alternative Perspectives of Nodal Program Costs

	Budget Cost Through Go-Live (1)	Nodal Surcharge Cost Recovery (1)(2)	Financial Statement Presentation Estimated Cost Categorization (3)	
			Capital Cost	Operating Cost
External resource cost	292,559,312	292,559,312	275,926,964	16,632,348
Internal labor cost	86,140,621	86,140,621	55,462,199	30,678,422
Hardware and hardware maintenance cost	54,417,538	54,417,538	50,066,645	4,348,893
Software and software maintenance cost	37,131,338	37,131,338	34,163,909	2,967,429
Administrative and employee expense	3,078,690	3,078,690	294,399	2,784,291
Subtotal - Direct cost	473,327,499	473,327,499	415,916,115	57,411,384
Indirect support cost allocation	17,803,472	17,803,472	15,644,033	2,159,439
Backfill labor cost allocation	8,479,263	8,479,263	7,450,786	1,028,477
Facilities cost allocation	7,856,531	7,856,531	6,903,588	952,943
Subtotal - Indirect cost	34,139,266	34,139,266	29,998,407	4,140,859
Subtotal - Direct and Indirect cost	507,466,765	507,466,765	445,914,522	61,552,243
Plus: Contingency funding	58,627,636	58,627,636	51,516,505	7,111,131
Plus: Financing cost during implementation	49,300,000	49,300,000	42,219,782	7,080,218
Plus: Financing cost after go-live	na	43,300,000	-	43,300,000
Subtotal	615,394,401	658,694,401	539,650,809	119,043,592
Less: Zonal / Nodal interdependent projects	na	(39,720,226)	(34,902,435)	(4,817,791)
Total	615,394,401	618,974,175	504,748,374	114,225,801

Notes:

- (1) Schedule based on the Nodal Program budget presented to the ERCOT Board of Directors on January 21, 2009 and on current order directing method of cost recovery.
- (2) The subtotal \$658,694,401 is lower than the \$660,000,000 figure presented to the Board in January 2009 as a result of a \$1,305,599 reduction in assumed financing cost.
- (3) Categorization of Nodal Program cost to capital cost and operating cost classification is estimated based on average categorization recorded through December 31, 2008. Actual categorization of Nodal Program cost incurred in 2009 and 2010 may be significantly different than shown in the schedule above because cost categorization is based on evaluation of accounting characteristics of individual invoices. The defining characteristics of future invoices are not known with certainty today.

Copy of Accounting Basics_20090210o Nodal Summary

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Alternatives:

1. Approve the requests made by ERCOT Staff as follows:
 - Approve the budget proposed by ERCOT Staff and authorize expenditures to complete the Nodal Program up to a total amount not-to-exceed \$658.7 million, consisting of the

following:

- Direct and indirect costs of \$507.5 million;
 - Contingency funding of \$58.6 million; and
 - Financing costs as determined based on the option selected by the Board at its meeting on February 17, 2009. For purposes of the not-to-exceed amount above, an interest cost estimate of \$92.6 million was assumed. This amount includes interest for both the period during implementation and after the go-live date consistent with Option 2a as identified in materials included with Agenda Item 11a of the Board meeting on February 17, 2009 (this is not an endorsement of Option 2a; Option 2a is simply the assumption that was included in the January 2009 Board materials);
 - Grant ERCOT officers the delegated authority to control all expense categories within this Nodal Program budget request with the exception of contingency funding which shall remain exclusively within the Board's authority; and
 - Approve a schedule proposed by ERCOT Staff and authorize completion of the Nodal Program by a date no later than December 31, 2010.
2. Request a modification of this request. This option will likely increase the risk associated with completion of the Nodal Program and could potentially cause a significant time delay. This option may not be consistent with instructions given to ERCOT Staff by the Chairman and Commissioners of the Public Utility Commission of Texas.
 3. Deny this request in its entirety. This option will halt work beyond February 28, 2009, on the Nodal Program; and absent any authorization to move forward, the Nodal Program will not be completed. This option may not be consistent with instructions given to ERCOT Staff by the Chairman and Commissioners of the Public Utility Commission of Texas.

Conclusion/Recommendation:

ERCOT respectfully requests the following:

- Approval of the budget proposed by ERCOT Staff and authorize expenditures to complete the Nodal Program up to a total amount not-to-exceed \$658.7 million, consisting of the following:
 - Direct and indirect costs of \$507.5 million;
 - Contingency funding of \$58.6 million; and
 - Financing costs as determined based on the option selected by the Board at its meeting on February 17, 2009. For purposes of the not-to-exceed amount above, an interest cost estimate of \$92.6 million was assumed. This amount includes interest for both the period during implementation and after the go-live date consistent with Option 2a as identified in materials included with Agenda Item 11a of the Board meeting on February 17, 2009 (this is not an endorsement of Option 2a; Option 2a is simply the assumption that was included in the January 2009 Board materials);
- The granting of delegated authority to ERCOT officers to control all expense categories within this Nodal Program budget request with the exception of contingency funding which shall remain exclusively within the Board's authority; and
- Approval of a schedule proposed by ERCOT Staff and authorization of completion of the Nodal Program by a date no later than December 31, 2010.



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

WHEREAS, the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) previously authorized a maximum not-to-exceed budget amount of \$363.5 million for the Texas Nodal Market Implementation Program (Nodal Program) through February 28, 2009, and the Board directed ERCOT not to spend any funds on the Nodal Program without further authorization from the Board after February 28, 2009;

WHEREAS, the Board previously acknowledged that the Nodal Program would not be complete as originally expected by January 1, 2009, and the Board previously directed ERCOT to prepare a final budget and schedule for the Nodal Program after the Public Utility Commission of Texas (Commission) completed its review of its requested Cost-Benefit Analysis (CBA);

WHEREAS, the Commission has received the findings of the CBA; the Board has recently received an oversight report from Utilicast, LLC, an independent third-party consultant engaged to review the Nodal Program budget and schedule; and ERCOT Staff has presented its preliminary Nodal Program budget and proposed Nodal Program Integrated Project Schedule at the Special Board meeting on January 21, 2009;

WHEREAS, after due consideration of the various alternatives, the Board deems it desirable and in the best interest of ERCOT to accept ERCOT Staff's recommendations with regard to the Nodal Program budget and schedule.

THEREFORE, IT IS HEREBY RESOLVED, that the Board hereby does the following:

- Approves the budget proposed by ERCOT Staff and authorize expenditures to complete the Nodal Program up to a total amount not-to-exceed \$658.7 million, consisting of the following:
 - Direct and indirect costs of \$507.5 million;
 - Contingency funding of \$58.6 million; and
 - Financing costs as determined based on the option selected by the Board at its meeting on February 17, 2009. For purposes of the not-to-exceed amount above, an interest cost estimate of \$92.6 million was assumed. This amount includes interest for both the period during implementation and after the go-live date consistent with Option 2a as identified in materials included with Agenda Item 11a of the Board meeting on February 17, 2009;
- Grants ERCOT officers the delegated authority to control all expense categories within this Nodal Program budget request with the exception of contingency funding which shall remain exclusively within the Board's authority; and
- Approves a schedule proposed by ERCOT Staff and authorizes completion of the Nodal Program by a date no later than December 31, 2010.



CORPORATE SECRETARY'S CERTIFICATE

I, Michael G. Grable, Corporate Secretary of ERCOT, do hereby certify that, at the February 17, 2009 ERCOT Board Meeting, the ERCOT Board of Directors passed a motion approving the above Resolution by a vote of _____.

IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____, 2009.

Michael G. Grable
Corporate Secretary