



Date: February 10, 2009
To: Board of Directors
From: Steve Byone, Vice President and Chief Financial Officer
Subject: Treatment of Investment Losses

Issue for the ERCOT Board of Directors

ERCOT Board of Directors Meeting Date: February 17, 2009

Agenda Item No.: 11d

Issue:

ERCOT Management seeks to formalize the policy direction it believes was delivered consistently by the ERCOT Board of Directors (Board) during the fourth quarter of 2008 relating to the treatment of investment losses ERCOT experienced on investment funds placed with The Reserve.

Background/History:

ERCOT receives and holds funds from Market Participants and Texas Regional Entity (Texas RE) for a variety of reasons including security deposits, settlement prepayments, and transmission congestion rights auction proceeds.

ERCOT Staff invests funds that it temporarily holds on behalf of Market Participants and Texas RE. Investment activity is governed by investment standards reviewed and approved by the ERCOT Board at least annually.

In late 2008, extraordinary economic conditions led ERCOT to record a loss on the investment funds it had placed with The Reserve. To reduce the risk of further deterioration of the situation and potentially greater exposure to loss, it was in ERCOT's best interest to bolster Market Participant and Texas RE confidence that funds held and invested by ERCOT on their behalf were safe and secure.

One way to strengthen Market Participant and Texas RE confidence in the safety of funds held by ERCOT on their behalf was to shield them from the losses and commit to pay a reasonable, market-based rate of interest income on funds they had placed with ERCOT.

Key Factors Influencing Issue:

The key factors influencing the decision include the following:

1. It was in ERCOT's best interest to strengthen Market Participant and Texas RE confidence that funds held by ERCOT on their behalf was safe and secure;
2. It was not in ERCOT's best interest for Market Participants and Texas RE to request withdrawal of funds held on their behalf during the last quarter of 2008; and
3. It was in ERCOT best interest to further strengthen the existing division between ERCOT, Inc. and Texas RE and to further promote their independence.



Alternatives:

There are three primary alternatives:

1. Accept Management's recommendation to formalize past direction,
2. Reject Management's recommendation to formalize past direction, or
3. Provide new direction to Management.

Conclusion/Recommendation:

ERCOT Management recommends that the ERCOT Board confirm its direction that (1) ERCOT bear losses recorded on investment in funds offered by The Reserve rather than uplift or otherwise share the losses with Market Participants and Texas RE, and (2) ERCOT pay Market Participants and Texas RE a reasonable, market-based rate of interest for the time that funds are held by ERCOT on their behalf.



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

WHEREAS, Electric Reliability Council of Texas, Inc. (ERCOT) receives and holds funds on behalf of Market Participants, Texas Regional Entity (Texas RE), and ERCOT, Inc.;

WHEREAS, ERCOT invests funds its holds on behalf of Market Participants, Texas RE, and ERCOT, Inc in instruments that comply with Board-approved investment corporate standards;

WHEREAS, ERCOT recorded loss on investments in funds managed by The Reserve loss during 2008 and remains exposed to potential additional losses in 2009;

WHEREAS, it is in ERCOT best interest to maintain Market Participant and Texas RE confidence that funds held by ERCOT on their behalf are safe and secure and thereby prevent excessive requests by Market Participants and Texas RE to withdraw funds from ERCOT; and

WHEREAS, it is in ERCOT's best interest to further strengthen the existing division between ERCOT, Inc. and Texas RE and to further promote their independence, therefore be it:

RESOLVED, that all losses – past and future – on investments maintained with The Reserve be borne by ERCOT, Inc. rather than be uplifted or shared with Market Participants or Texas RE.

RESOLVED FURTHER, that Market Participants and Texas RE be paid a reasonable, market-based rate of interest for the time that funds are held by ERCOT on their behalf.

CORPORATE SECRETARY'S CERTIFICATE

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

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

Michael G. Grable
Corporate Secretary