Date: March 10, 2009
To: ERCOT Board of Directors
From: Steve Byone, Vice President and Chief Financial Officer
Subject: Reconsideration of Nodal Surcharge Rate

Issue for the ERCOT Board of Directors

ERCOT Board of Directors Meeting Date: March 17, 2009
Agenda Item No.: 12b

Issue:
At the Board of Directors (Board) Meeting on February 17, 2009, ERCOT received authorization to make a filing with the Public Utility Commission of Texas (Commission), in accordance with the June 13, 2007 Order Nunc Pro Tunc in Docket No. 32686, to: (a) request an increase in the Nodal Surcharge to $0.273 or $0.285 per MWh in accordance with the Flat Fee Options (2a or 2b) per the analyses provided and contingent upon any interim relief authorized by the Commission prior to ERCOT's next filing, and (b) seek a deferral of Nodal debt repayment that had been scheduled to begin in 2009 as contemplated in prior Commission filings.

ERCOT also received Board authorization to incur debt under approved debt facilities for the revised estimate of Nodal Program costs not concurrently funded with revenue available from the Nodal Surcharge.

Subsequent to the Board meeting, at the February 26, 2009 Open Meeting of the Commission, Commissioners voiced strong concern with the declining level of revenue funding for the project. Commissioners requested the Board consider establishing a written policy on debt funding levels for ERCOT and expressed dissatisfaction regarding the proposed equity funding level associated with the new Nodal Program surcharge request. Commissioners indicated a desire that the equity funding level for ERCOT projects overall (presumably, including the Nodal Program) be at least 40 percent. While recent Board actions have resulted in non-Nodal project revenue funding of at least 40%, the increase authorized by the Board in February for the Nodal surcharge would result in 34 percent to 37 percent revenue funding during the development period for that project.

Given the new information provided by the Commission, ERCOT staff recommends the Board re-consider the previous decision to request a Nodal Surcharge increase based upon Option 2a or 2b as approved during the February 17, 2009 meeting.

Background/History:
At its meeting on February 17, 2009, the Board considered the options for financing the Nodal Program as described in Exhibit A. For ease of comparison between options, please note that these options have not been updated since the Board's February 2009 meeting.

Option-Specific Assumptions:

- **Option 1 – No-change option**
  - Nodal Surcharge of $0.169 per MWh remains in effect until all ERCOT costs to implement a nodal market are recovered.
- **Option 2a and 2b – Flat-fee options**
  - Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009 (under option 2a).
  - Nodal Surcharge increased to $0.226 per MWh effective March 1, 2009 (under option 2b).
  - At January 1, 2010, Nodal Surcharge is set at a flat rate projected to recover remaining costs over the average useful life of the assets (through December 2014) (under options 2a and 2b).
- **Options 3a and 3b – Historical ERCOT Capex Revenue Funding Options (40 percent)**
  - Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009 (under option 3a).
  - Nodal Surcharge is increased to $0.226 per MWh effective March 1, 2009 (under option 3b).
  - At January 1, 2010, Nodal Surcharge is set to fund 40 percent of the estimated total cost of the project by the "go-live" date consistent with historical ERCOT base operations. Nodal Surcharge then remains constant until all remaining costs incurred by ERCOT to implement the nodal market are fully recovered (under options 3a and 3b).
- **Options 4a and 4b – Rate-parity options**
  - Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009 (under option 4a).
  - Nodal Surcharge is increased to $0.226 per MWh effective March 1, 2009 (under option 4b).
  - At January 1, 2010, Nodal Surcharge is set at a level consistent with the projected System Administration Fee for 2010. Nodal Surcharge then remains constant until all remaining costs incurred by ERCOT to implement the nodal market are fully recovered (under options 4a and 4b).
- **Options 5a and 5b – 100 percent funding options**
  - Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009 (under option 5a).
  - Nodal Surcharge is increased to $0.226 per MWh effective March 1, 2009 (under option 5b).
  - At January 1, 2010, Nodal Surcharge is set to recover by the Nodal market "go-live" date all costs incurred by ERCOT to implement the nodal market (under options 5a and 5b).

Options 1 and 2 are not expected to achieve the desired minimum revenue contribution level of 40 percent prior to the "go live" date.

Options 3, 4 and 5 are expected to result in attainment of the minimum desired revenue

contribution level of 40 percent prior to the "go live" date.

Key Factors Influencing Issue:

- ERCOT needs sources of funding to support the proposed increase in Nodal Program spending. Board approval is required to seek a change in the Nodal Surcharge.
- The current Board authorization to file for a change in the Nodal Surcharge rate consistent with Option 2 is not expected to achieve the desired minimum revenue contribution level of 40 percent prior to the "go live" date.
- The Commission has expressed a desire that ERCOT fund projects with a minimum of 40 percent equity.
- Board approval is required to borrow money to fund Nodal Program spending in excess of the current revenue received from the approved Nodal Surcharge.

Alternatives:

A. Leave the February 17, 2009 authorizations in place and make a filing with the Commission consistent with such authorizations.

B. Rescind the authorization of February 17, 2009; and;

1) Authorize ERCOT to incur debt under approved debt facilities for the revised estimate of Nodal Program costs not concurrently funded with revenue from the Nodal Surcharge; and

2) Make a filing with the Commission seeking a deferral of Nodal debt repayment that had been scheduled to begin in 2009 as contemplated in prior Commission filings: and

3) Seek:

(a) an increase in the Nodal Surcharge rate consistent with Option 3a or 3b, effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered; or

(b) an increase in the Nodal Surcharge rate consistent with Option 4a or 4b, effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered; or

(c) an increase in the Nodal Surcharge rate consistent with Option 5a or 5b, effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered; or

(d) an increase in the Nodal Surcharge rate consistent with other directives as expressed by the Board with such rate remaining in effect until all Nodal Program costs are recovered.

Conclusion/Recommendation:

ERCOT respectfully requests that the Board authorize Alternative B together with one of the options listed under item 3.

ERCOT

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

WHEREAS, the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) deems it desirable and in ERCOT's best interest to obtain a source of funding to cover the revised costs ERCOT will incur related to implementing the Texas Nodal Market Implementation Program (Nodal Program);

WHEREAS, ERCOT must request approval of the Public Utility Commission of Texas (Commission) for ERCOT to collect a fee in the form of a surcharge assessed in addition to its System Administration Fee (or some other comparable mechanism) to pay for Nodal Program costs ERCOT incurs;

WHEREAS, the Commission, in its Docket No. 32686, approved ERCOT's nodal market implementation surcharge (Nodal Surcharge) in 2007;

WHEREAS, ERCOT now needs to increase the budget for the Nodal Program 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 flat-fee option (Option 2) 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;

WHEREAS, at its Open Meeting on February 26, 2009, the Commission indicated a desire that the equity funding level for ERCOT projects overall (presumably, including the Nodal Program) be at least 40 percent, which is not consistent with the flat-fee option (Option 2) approved by the Board at its meeting on February 17, 2009; and

WHEREAS, after discussion and due consideration of the alternatives, the Board has determined that prior approval of the flat-fee option (Option 2) should be rescinded, that it should authorize ERCOT to incur debt under approved debt facilities for the revised estimate of Nodal Program costs not concurrently funded with revenue from the Nodal Surcharge, that it authorizes ERCOT to make a filing with the Commission seeking a deferral of Nodal debt repayment that had been scheduled to begin in 2009 as contemplated in prior Commission filings, and that it authorizes ERCOT to seek an increase in the Nodal Surcharge rate consistent with historical ERCOT capex revenue funding options (40 percent) (Option 3), rate-parity options (Option 4), or 100 percent funding options (Option 5) or other directives of the Board given at its meeting on March 17, 2009, effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered;

THEREFORE, BE IT RESOLVED, the Board hereby:

(1) Rescinds its approval of the flat-fee option (Option 2) approved at its meeting on February 17, 2009;

(2) Authorizes ERCOT to incur debt under approved debt facilities for the revised estimate of Nodal Program costs not concurrently funded with revenue from the Nodal Surcharge; and

(3) Authorizes ERCOT to make a filing with the Commission seeking authority in accordance with the June 13, 2007 Order Nunc Pro Tunc in Docket No. 32686, to request an increase in the Nodal Surcharge rate consistent with directives provided by the Board during its March 17, 2009 meeting and to request such increase be effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered, and further to seek a deferral of Nodal debt repayment that had been scheduled to begin in 2009 as contemplated in prior Commission filings.

CORPORATE SECRETARY'S CERTIFICATE

I, Michael G. Grable, Corporate Secretary of ERCOT, do hereby certify that, at its March 17, 2009 meeting, the ERCOT Board passed a motion approving the above Resolution by voice vote with one abstention (Mr. Fehrenbach).

IN WITNESS WHEREOF, I have hereunto set my hand this 24th day of March, 2009.

Michael G. Grable
Corporate Secretary

Background - Reconsideration of Nodal Surcharge Rate (Vote)

Steve Byone

Vice President and Chief Financial Officer

Board of Directors Meeting

March 17, 2009

Reconsideration of Nodal Surcharge Rate (Vote)

During the February 26, 2009 PUCT Open Meeting, Chairman Barry T. Smitherman requested that ERCOT develop a plan to address the equity contribution level for the Nodal Program…

- **"If we are going to go forward with this amount of debt we need to have a policy in place where everybody at the ERCOT table agrees and we agree this is how much debt we are going to have rather than defaulting to well lets have more debt because that means this year and next year our assessment is lower." – *Barry T. Smitherman***

- **"I would like a plan for how to get this debt to equity ratio back in line with what we have always talked about" – *Barry T. Smitherman***

- **"It has been the Commission's policy for entities that we regulate to have a 60/40 debt to equity ratio" – *Barry T. Smitherman***

In response to the Commission's feedback, ERCOT staff recommends the Board re-consider the amount of the requested Nodal Surcharge increase .

Reconsideration of Nodal Surcharge Rate (Vote)

	No Change	Flat Fee Options		Historical ERCOT Capex Revenue Funding Options (40%)		Rate Parity Options		100% Funding Options	
	Option 1	Option 2a	Option 2b	Option 3a	Option 3b	Option 4a	Option 4b	Option 5a	Option 5b
	$0.169 through full recovery	$0.169 through 2009; Flat fee through 2014	$0.226 through 2009; Flat fee through 2014	$0.226 through 2009; 40% rev funding by go-live	$0.169 through 2009; 40% rev funding by go-live	$0.169 through 2009; $0.473 thereafter	$0.226 through 2009; $0.473 thereafter	$0.169 through 2009; 100% rev funding by go-live	$0.226 through 2009; 100% rev funding by go-live
Nodal costs to be financed	526.4	526.4	526.4	526.4	526.4	526.4	526.4	526.4	526.4
Debt financing costs	146.0	92.6	89.8	78.7	75.4	64.1	61.0	38.9	38.0
Costs recoverable via Nodal Surcharge	$ 672.4	$ 618.9	$ 616.1	$ 605.0	$ 601.8	$ 590.5	$ 587.4	$ 565.3	$ 564.4
Expected Nodal Surcharge - 2009 ($/MWh)	$ 0.169	$ 0.169	$ .169 / .226	$ .169 / .226	$ 0.169	$ 0.169	$ .169 / .226	$ 0.169	$ .169 / .226
Expected Nodal Surcharge - 2010 thru full recovery ($/MWh)	$ 0.169	$ 0.285	$ 0.273	$ 0.324	$ 0.375	$ 0.473	$ 0.473	$ 1.315	$ 1.264
Projected end of collection period (if rate remains in effect for full period)	2nd Qtr 2019	4th Qtr 2014	4th Qtr 2014	1st Qtr 2014	3rd Qtr 2013	4th Qtr 2012	3rd Qtr 2012	4th Qtr 2010	4th Qtr 2010
Estimated "peak" Nodal debt (curr - Dec 2008, all options - Dec 2010)	383.6 Dec-10	344.7 Dec-10	331.7 Dec-10	314.8 Dec-10	327.4 Dec-09	327.4 Dec-09	311.4 Dec-09	327.4 Dec-09	311.4 Dec-09
Percent revenue funding during development	27.1%	34.5%	37.0%	40.2%	40.2%	46.5%	49.7%	100.0%	100.0%

Note: All amounts are in $ millions unless otherwise noted.

EXHIBIT A TO AGENDA ITEM 12b

Historical ERCOT Capex Revenue Funding Options (40%)

	No Change	Flat Fee Options				Rate Parity Options		100% Funding Options	
	Option 1	Option 2a	Option 2b	Option 3a	Option 3b	Option 4a	Option 4b	Option 5a	Option 5b
	$0.169 through full recovery	$0.169 through 2009; Flat fee through 2014	$0.226 through 2009; Flat fee through 2014	$0.226 through 2009; 40% rev funding by go-live	$0.169 through 2009; 40% rev funding by go-live	$0.169 through 2009; $0.473 thereafter	$0.226 through 2009; $0.473 thereafter	$0.169 through 2009; 100% rev funding by go-live	$0.226 through 2009; 100% rev funding by go-live
Nodal costs to be financed	526.4	526.4	526.4	526.4	526.4	526.4	526.4	526.4	526.4
Debt financing costs	146.0	92.6	89.8	78.7	75.4	64.1	61.0	38.9	38.0
Costs recoverable via Nodal Surcharge	$ 672.4	$ 618.9	$ 616.1	$ 605.0	$ 601.8	$ 590.5	$ 587.4	$ 565.3	$ 564.4
Expected Nodal Surcharge - 2009 ($/MWh)	$ 0.169	$ 0.169	$ .169 / .226	$ .169 / .226	$ 0.169	$ 0.169	$ .169 / .226	$ 0.169	$ .169 / .226
Expected Nodal Surcharge - 2010 thru full recovery ($/MWh)	$ 0.169	$ 0.285	$ 0.273	$ 0.324	$ 0.375	$ 0.473	$ 0.473	$ 1.315	$ 1.264
Projected end of collection period (if rate remains in effect for full period)	2nd Qtr 2019	4th Qtr 2014	4th Qtr 2014	1st Qtr 2014	3rd Qtr 2013	4th Qtr 2012	3rd Qtr 2012	4th Qtr 2010	4th Qtr 2010
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