DIRECT TESTIMONY OF

STEVE BYONE

VICE-PRESIDENT AND CHIEF FINANCIAL OFFICER

ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.

IN SUPPORT OF

ERCOT'S APPLICATION FOR APPROVAL OF A

REVISED NODAL MARKET IMPLEMENTATION SURCHARGE

DIRECT TESTIMONY OF STEVE BYONE

I. BACKGROUND AND SUMMARY OF RELIEF REQUESTED

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

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

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

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS CHIEF FINANCIAL OFFICER.

A. I am responsible for all treasury functions including financing, cash management, and credit analysis. I also oversee all accounting operations including accounts receivable, accounts payable, fixed assets, financial reporting, and budgeting/forecasting. Additionally, I oversee the company's procurement and enterprise risk management functions. Finally, I am responsible for management of the $100 million-plus corporate operating budget and I am the primary liaison between the Finance and Audit Committee of the Board of Directors and ERCOT management.

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. I have a Bachelor of Science degree in Accounting and Business Administration from Northwestern State University in Natchitoches, Louisiana. I also have a Masters of Business Administration, with a concentration in finance, from Louisiana Tech University. I am also a Certified Public Accountant. I have more than 25 years experience in the energy field in a wide variety of positions, including Vice-Presidential positions as Chief Financial Officer and Chief Risk Officer. Prior to joining ERCOT, I was a Vice-President and Chief Risk Officer for Progress Energy, a Fortune 250 diversified energy company with more than 24,000 megawatts of generation capacity and $9 billion in annual revenues. Before Progress Energy, I held a number of positions with Mirant Corporation, including Co-Chief Commercial Officer and Director of Corporate Finance & Chief Risk Officer for Mirant Europe, and Vice-President and Chief Control Officer with Mirant Americas Energy Marketing. In these positions, I had a number of responsibilities, including a primary role in the launch of a European venture, where I oversaw development of corporate, legal, and tax structures; secured working capital funding; developed business processes; and spearheaded hiring of staff. Earlier in my career, I held significant management and technical positions with Enron Corp., including managing world-wide cash flow, managing interest rate exposure and managing treasury stock repurchases. I also filled key roles in finance, accounting, and risk management before leaving Enron Corp. in 1996.

Q. HAVE YOU EVER TESTIFIED BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS?

A. Yes, I testified in Docket 31824 (ERCOT's 2006 System Administration fee case), in Docket Nos. 32686, 35428, and 36412 (ERCOT's requests for approval of the Nodal Program surcharge). In addition, I regularly make presentations at Commission Open Meetings regarding ERCOT's financial status and plans.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to explain the basis for and support ERCOT's request for a revised Nodal surcharge. ERCOT requests that the Commission: (1) adopt the interim surcharge of $0.226 per Megawatt hour ("MWh") included in the pending settlement of Docket No. 36412[1] for the remainder of calendar year 2009; and (2) approve a revised Nodal surcharge, effective January 1, 2010, with the rate dependent upon the implementation date for the interim surcharge, as set forth in Table 1 below.

[1] Docket No. 36412, *ERCOT Application For Approval of a Revised Nodal Surcharge and Request For Interim Relief* (pending).

Table 1: Impact of interim rate implementation date on level of revised Nodal surcharge effective Jan. 1, 2010.

Implementation date of interim rate increase from $0.169 to $0.226 per MWh	**Rate needed January 1, 2010 to ensure 40% revenue contribution during development**
June 1, 2009	$0.335
July 1, 2009	$0.341
August 1, 2009	$0.347
September 1, 2009	$0.353
No increase in $0.169 rate until Jan. 1, 2010	$0.375

ERCOT requests that the revised rate be effective January 1, 2010, and remain in effect until all Nodal Program costs are recovered, currently expected to be in 2014. Alternatively, if the Commission rejects the interim surcharge settlement and leaves the Nodal surcharge at its current level of $0.169 per MWh for the remainder of 2009, ERCOT requests that the Commission approve a revised Nodal surcharge of $0.375 per MWh, also effective January 1, 2010.[2]

Q. PLEASE EXPLAIN HOW ERCOT HAS BEEN FUNDING THE TEXAS NODAL MARKET IMPLEMENTATION PROGRAM.

A. ERCOT is funding the Texas Nodal Market Implementation Program ("Texas Nodal" or "Nodal Program") by means of a special purpose surcharge approved by the Commission in Docket Nos. 32686 and 35428 (the "Nodal surcharge"). The approved Nodal surcharge is scheduled to be collected until ERCOT recovers

[2] The Board of Directors resolution authorizing ERCOT to request the Nodal surcharge proposed in this proceeding is attached to my testimony as Exhibit SB-1.

the costs of implementing the Nodal market, including the repayment of debt and related interest costs associated with Nodal implementation. Collection of the Nodal surcharge was originally estimated to continue through 2012. In Docket No. 35428, the Commission approved a Settlement Agreement supporting a Nodal Surcharge of $0.169 per MWh.

Q. DID ERCOT REQUEST A CHANGE IN THE NODAL SURCHARGE IN ANOTHER DOCKET SINCE DOCKET NO. 35428?

A. Yes, ERCOT requested the Commission approve an interim surcharge amount in Docket No. 36412. After ERCOT concluded in May 2008 that the Nodal market would not be completed by the scheduled Go-Live deadline of January 2009, the Nodal Program undertook a comprehensive effort to re-plan the schedule and budget for completing the Nodal Program. As detailed in the testimony of ERCOT Chief Operating Officer Mr. Doggett, that process led to the development of the revised Go-Live date and budget that ERCOT asks the Commission to approve in this docket. In addition, in September 2008, the Commission initiated an update of the cost-benefit analysis ("CBA") of Nodal market implementation, and ERCOT's Board of Directors retained the consulting firm Utilicast to conduct program reviews of the Nodal Program.

During this period, as the Nodal Program was under review, the program was also nearing its previously authorized spending limit. In November 2008, in order to prudently provide for continued funding of Texas Nodal, ERCOT filed, in Docket

No. 36412, its request for an interim increase in the Nodal surcharge. ERCOT proposed that the Nodal surcharge increase to $0.38 per MWh, effective February 1, 2009, and remain at that level, on an interim basis, until the Commission approved a revised schedule, budget, and surcharge to fund Texas Nodal.

ERCOT's request to institute a significant increase in the surcharge in early 2009 generated vocal opposition from several intervenor parties in Docket No. 36412, and ERCOT initiated discussions with the parties to seek a settlement to the contested case proceeding. In order to reach a settlement that would facilitate continued funding for the Nodal Program, ERCOT agreed to reduce its interim Nodal surcharge request to $0.226 per MWh. On January 5, 2009, ERCOT filed a partial stipulation of the issues in Docket No. 36412 that included the $0.226 per MWh interim rate recommendation. On March 27, 2009, the Commission voted to leave the stipulation pending in Docket No. 36412, and to extend ERCOT's authority to collect the current $0.169 per MWh Nodal surcharge until May 31, 2009, at which time it will determine whether to approve the proposed interim rate.

Q. DOES THE PENDING INTERIM RELIEF REQUEST IN DOCKET NO. 36412 HAVE AN IMPACT ON THE NODAL SURCHARGE REVISION ERCOT IS RECOMMENDING IN THIS PROCEEDING?

A. Yes. If the Nodal surcharge remains at $0.169 per MWh, the surcharge will generate less revenue funding for ongoing Nodal Program operations than if the

Commission approves the interim increase to $0.226 per MWh. If the interim increase is approved, the additional $0.057 per MWh in Nodal surcharge revenue will fund Nodal Program costs that would otherwise be funded by additional debt. As I discuss in detail later in my testimony, the ERCOT Board of Directors and the Commission have strongly supported the establishment of prudent equity (revenue) project funding requirements that demand additional revenue funding for the Nodal Program. ERCOT continues to strongly recommend the approval of the interim increase in the Nodal surcharge, which is consistent with that overall goal.

Q. HOW WAS THE PENDING INTERIM SURCHARGE TAKEN INTO ACCOUNT IN CALCULATING ERCOT'S PROPOSAL FOR A REVISED NODAL SURCHARGE?

A. The ERCOT Board of Directors approved a recommended increase in the Nodal surcharge that is linked to the Commission's determination whether to approve the interim increase to $0.226 per MWh or leave the current $0.169 per MWh surcharge in place for the remainder of 2009.

Q. WHAT IS THE SURCHARGE REVISION ERCOT IS RECOMMENDING?

A. ERCOT recommends that, once the Commission determines whether to approve the interim surcharge and establishes an effective date for any change, the surcharge approved by the Commission (*i.e.*, $0.226 or $0.169 per MWh) remain

in place until the end of calendar year 2009. This approach provides those entities that pay the Nodal surcharge sufficient opportunity to incorporate the revised Nodal surcharge approved in this proceeding into their business plans for 2010 and beyond. If ERCOT's recommendation is adopted, the new revised surcharge will not go into effect until January 1, 2010. The amount of the Nodal surcharge recommended by ERCOT also differs based on when and whether the interim surcharge is approved by the Commission: if the Commission approves the interim increase for the balance of calendar year 2009, ERCOT recommends the revised Nodal surcharge be set based on the effective date of the interim increase (the interim rates associated with various effective dates are set forth in Table 1 above); if the Commission opts to maintain the $0.169 Nodal surcharge through 2009, ERCOT recommends the revised Nodal surcharge be set at a higher rate, namely $0.375 per MWh.

Q. WHAT IS THE REASON FOR THE DIFFERENCE IN THE RECOMMENDED AMOUNT?

A. The proposed interim surcharge would generate more revenue for the Nodal Program during 2009 than would the current surcharge. If ERCOT is permitted to charge the interim Nodal surcharge for the remaining months of 2009, it would mitigate the need to increase the revenue funding of the program in 2010 and beyond. Therefore, the overall level of the revised Nodal surcharge could be lower without forcing ERCOT to incur unacceptable amounts of debt to finance the remaining costs of the Nodal market transition.

II. CHANGED CIRCUMSTANCES JUSTIFY ERCOT'S REQUEST FOR AN INCREASE IN THE NODAL SURCHARGE PREVIOUSLY APPROVED BY THE COMMISSION

Q. WHAT ARE THE PRIMARY FACTORS ERCOT CONSIDERS WHEN DETERMINING THE APPROPRIATE LEVEL OF THE NODAL SURCHARGE?

A. There are six general factors ERCOT considers when examining the Nodal surcharge level:

- Credit market conditions, and how they impact ERCOT's ability to finance capital projects.
- ERCOT's current debt load.
- The need to preserve borrowing capacity for unexpected future needs.
- Increased Nodal Program cost due to interest expense.
- Matching of the payment for the Nodal Program via the Nodal surcharge with the benefit from Nodal Program assets after Go-Live.
- The desire for a consistent, predictable Nodal surcharge that will not fluctuate unreasonably during the collection period.

Q. WHEN ERCOT CONSIDERED THESE FACTORS IN ITS JANUARY 2008 REQUEST FOR THE CURRENT $0.169 PER MWH NODAL SURCHARGE, WHAT WERE ITS UNDERLYING ASSUMPTIONS?

A. The $0.169 per MWh Nodal surcharge approved in Docket No. 35428 was based on certain key assumptions:

- Nodal implementation efforts funded by the Nodal surcharge would terminate as of January 1, 2009 (assuming a December 2008 Go-Live date).

- The total Nodal Program costs recoverable through the Nodal Surcharge, including debt service interest costs, would be approximately $311.3 million.

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

- It would be financially prudent, as part of ERCOT's overall financial picture, for ERCOT to fund 27.4 percent of Nodal Program costs during development (*i.e.*, on a "pay as you go" revenue basis while the Nodal Market was being implemented) and the remainder with debt financing.

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

A. Yes. In fact, all of the major assumptions I identified above have changed since the Commission approved the current Nodal surcharge. First, the Go-Live date for the Nodal Market has been delayed. Second, the costs of Nodal implementation will exceed the amount projected when the Commission approved the Nodal surcharge. Third, conditions in the credit markets are dramatically different from what they were when the current Nodal surcharge was approved, and remain extremely uncertain. Fourth, ERCOT's previous ability to place a heavy reliance on debt to fund the bulk of the Nodal Program has changed due to the adoption of an ERCOT Financial Corporate Standard that dictates an increased reliance on revenue funding to complete the Nodal Program.

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

A. The Commission approved the Nodal surcharge as a way to fund the development and implementation of the Nodal market. If the January 1, 2009 Go-Live deadline had been achieved, the development and implementation costs to be funded by the Nodal surcharge would have ceased when the Nodal Market opened at the end of 2008. The delay in the completion of Nodal implementation means that the Nodal Program will continue to incur substantial costs through the new proposed Go-Live deadline of December 31, 2010. In addition, ERCOT had originally anticipated beginning in 2009 to pay down debt incurred to fund implementation of the Nodal market. Given the ongoing development work on the project, ERCOT anticipates the need to incur more debt than previously planned and to defer repayment of debt.

Q. WHAT IMPACT DOES THE INCREASE IN THE OVERALL COST OF COMPLETING THE NODAL PROGRAM HAVE ON ERCOT'S CONSIDERATION OF A SURCHARGE AMOUNT?

A. Increased program costs must be covered by ERCOT either from a revenue stream or by additional debt financing. Historically, ERCOT has funded Nodal implementation primarily with debt (with roughly 26 percent funded on a "pay as you go" revenue basis through February 28, 2009). Looking forward, with a much larger amount of program costs to recover, ERCOT has had to carefully examine the impact that increased Nodal Program debt will have on ERCOT's overall financial health. There are a number of considerations ERCOT must examine in this regard. First, ERCOT must cautiously manage its current debt

load. ERCOT has borrowed over $220 million through February 2009 to fund Nodal Program costs in addition to borrowings to fund other capital expenditures. Second, ERCOT needs to preserve an adequate level of borrowing capacity for other planned projects as well as for unexpected future needs. Maintaining a source of available credit to address potential future borrowing needs for unexpected events is prudent. Third, increased debt funding for the Nodal Program adds significantly to overall Nodal implementation cost due to increased interest expense. That is, the combination of higher Nodal Program debt levels together with increases in the length of time over which Nodal Program debt remains outstanding add to the overall costs of the Nodal Program. Finally, ERCOT must comply with its corporate financial standards while financing the Nodal Program. A recent change in ERCOT's Financial Corporate Standard has had a significant impact on ERCOT's Nodal surcharge proposal, as detailed later in my testimony.

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

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

- Banks are being forced to properly reflect the impact of troubled loans and therefore in many cases have less capital available for lending.

- In some cases, banks which do have capital to lend are preserving the limited capital for their "choice" customers. Moreover, if the banks do lend, they are charging more for it.

- Some investors from whom ERCOT might seek financing are either standing on the sidelines waiting for things to clear, or are indicating that credit will only be provided under much more onerous terms.

- Consolidations of major banking institutions are taking place at a high rate. The combined entities are taking time to consolidate their lending and rebalance their portfolios which, in turn, contributes to a smaller market for ERCOT debt.

Having recently completed two financings, I believe that ERCOT could still obtain debt financing to fund a reasonable percentage of Nodal costs; however, it is difficult at this time to determine the costs ERCOT might have to pay. ERCOT would ultimately borrow under market terms which, while reasonable at the date the funds are borrowed, may not appear reasonable when viewed over a historical period of time. These considerations certainly affect ERCOT's judgment about the amount of additional debt to devote to funding the Nodal Program.

Q. PLEASE EXPLAIN HOW THE CHANGED CIRCUMSTANCES YOU HAVE DESCRIBED AFFECT ERCOT'S VIEW OF THE PRUDENCE OF CONTINUING TO FUND NODAL AT THE HISTORICAL LEVEL OF REVENUE CONTRIBUTION DURING THE DEVELOPMENT PERIOD.

A. Thus far, the revenue contribution to Nodal Program funding accounts for only 26 percent of costs incurred through February 2009, with the remaining expenditures

being funded through debt. I believe it is critical that the Nodal Program's prospective expenditures be recovered with a much greater emphasis on "pay as you go" revenue funding. ERCOT has already borrowed approximately $220 million through February 2009 to fund the Nodal Program and when combined with other required borrowing is carrying a debt load of approximately $334 million as of February 2009. In looking back on previous financing strategies, an incremental $200 million of debt resulting from the Nodal Program was deemed manageable based on the assumptions underlying the original Nodal Program funding plan filed in Docket 35428. Most importantly, the $200 million debt funding for the Nodal Program represented a "peak" level with the expectation that this debt load would quickly be extinguished, thus freeing up ERCOT's balance sheet. It is important to remember, however, that Nodal Market implementation is not the only ERCOT project that may call for additional debt financing. On the horizon, but not yet fully quantified, are financial needs related to updating ERCOT's data centers, a technology infrastructure refresh, and undertaking responsibilities in new areas such as advanced metering. Moreover, there are always unanticipated needs that require ERCOT to call on credit facilities to meet critical institutional needs. If the Nodal Program absorbs a disproportionate share of ERCOT's debt capacity, ERCOT's financial capabilities may be unduly constrained when they are needed most.

Q. HAS ERCOT RECEIVED GUIDANCE FROM THE COMMISSION AND THE ERCOT BOARD OF DIRECTORS REFLECTING THE DEVELOPMENTS YOU HAVE IDENTIFIED?

A. Yes. As the cost of completing the Nodal Program has become clearer in recent months, the Commission has expressed concern on several occasions about the impact on ERCOT's financial health. The Commission has consistently encouraged ERCOT to maintain a minimum 40 percent equity (revenue) funding of its project budgets. As Chairman Smitherman reiterated at the February 26, 2009 Commission Open Meeting, "[i]'s been … the Commission's policy with regard to the entities that we regulate that they have a 60/40 debt-to-equity ratio."[3] In addition, Chairman Smitherman urged ERCOT to implement "a plan for how to get this debt-to-equity ratio back in line with what we have always talked about."[4]

Q. DID THE ERCOT BOARD IMPLEMENT SUCH A PLAN?

A. Yes. At its March 17, 2009 meeting, the ERCOT Board of Directors revised the ERCOT Financial Corporate Standard to formally address ERCOT's requirement to revenue fund a minimum level of project budgets. The Financial Corporate Standard is the "framework from which ERCOT's financial integrity will be maintained while serving the long-term interests of the company and the ERCOT market." In the Financial Corporate Standard, ERCOT "recognizes that maintaining financial integrity is critical to accomplishing its corporate goals and

[3] Open Meeting Transcript, Agenda Item 13, Docket No. 36412, at 49 (Feb. 26, 2009).

[4] *Id.*

discharging ERCOT's primary responsibilities."[5] The revision to the Financial Corporate Standard adopted at the March 2009 ERCOT Board meeting establishes that ERCOT will fund projects with at least 40 percent revenue. The new requirement provides as follows:

> **Sources of Financing.** ERCOT will use a combination of equity (revenue funding) and debt to finance current year Project activity. In determining the combination of equity and debt to be used, ERCOT will consider the impact of the current year decision on future years, but in no event will ERCOT propose to revenue fund less than 40 percent of Project Budgets.[6]

The change to the Financial Corporate Standard embodies the plan for ensuring a consistent and prudent level of equity contribution for projects that the Commission urged ERCOT to adopt to ensure its financial health.

Q. DOES THE CHANGE TO THE FINANCIAL CORPORATE STANDARD APPLY TO NODAL PROGRAM FUNDING?

A. Yes. The requirement to seek revenue funding of at least 40 percent of project budgets applies to all ERCOT project budgets, including the Nodal Program budget. It is therefore incumbent on ERCOT to manage Nodal Program funding in a manner that will move the equity (revenue) contribution level of the Nodal Program from the current 26 percent contribution as of February 2009 up to 40 percent of project implementation costs by the "Go-Live" date.

---

[5] A copy of the ERCOT Financial Corporate Standard, as amended to reflect the recent changes discussed herein, is attached to my testimony as Exhibit SB-2.
[6] Exhibit SB-2, ERCOT Financial Corporate Standard, at 3.

III. OPTIONS FOR THE REVISED NODAL SURCHARGE CONSIDERED BY ERCOT

Q. DID ERCOT CONSIDER OTHER ALTERNATIVES FOR THE NODAL SURCHARGE BESIDES THE ONE REFLECTED IN ERCOT'S REQUEST IN THIS PROCEEDING?

A. Yes. ERCOT's Finance Department presented five alternatives for Nodal Program funding to ERCOT's Finance and Audit Committee and Board of Directors. As noted earlier in my testimony, all but one of the options presented include alternatives that depend on whether the Commission adopts the interim Nodal surcharge of $0.226 included in the Settlement Agreement pending in Docket No. 36412.

<u>Option 1: No change in Nodal surcharge.</u>

- Nodal Surcharge of $0.169 per MWh remains in effect until all ERCOT costs to implement the Nodal market are recovered.
- Nodal surcharge level – 2009 to full recovery of Nodal Program costs: $0.169 per MWh.

<u>Option 2a and 2b: Flat-fee through projected useful life of assets.</u>

- Option 2a: Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009.
- Option 2b: Nodal Surcharge increased to $0.226 per MWh effective March 1, 2009, per Docket No. 36412 settlement.[7]

[7] The assumption regarding the adoption of the $0.226 per MWh surcharge on March 1, 2009 was used to provide the ERCOT Board of Directors an estimate of the impact of the change in the Nodal surcharge; ERCOT is aware that the Commission did not approve a change in the Nodal

- Options 2a and 2b: On 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).
- Nodal surcharge level – 2010 to full recovery of Nodal Program costs: $0.285 (Option 2a) or $0.273 (Option 2b) per MWh.

<u>Options 3a and 3b: Fund Nodal Program with 40% equity (revenue) by the "Go-Live" date.</u>

- Option 3a: Nodal Surcharge increased to $0.226 per MWh effective March 1, 2009, per Docket No. 36412 settlement. Option 3a has been revised in Table 2 below to reflect an assumed effective date of June 1, 2009 for the adoption of the $0.226 per MWh surcharge, with the understanding that the determination of the effective date is still under consideration by the Commission.
- Option 3b: Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009.
- Options 3a and 3b: On 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 and amended ERCOT Financial Corporate Standard. Nodal Surcharge then remains constant until all remaining costs incurred by ERCOT to implement the nodal market are fully recovered.

---

surcharge as of March 1, 2009, and has extended the $0.169 per MWh Nodal surcharge until May 31, 2009. As noted above, ERCOT changed the effective date assumption applicable to the summary description of Option 3 (the option adopted by the Board of Directors) so that it will reflect the Commission's March 27, 2009 determination that the interim surcharge will not go into effect before June 1, 2009.

- Nodal surcharge level 2010 to full recovery of Nodal Program costs: $0.335 (Option 3a) or $0.375 (Option 3b) per MWh.

Options 4a and 4b: Rate-parity options:

- Option 4a: Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009.
- Option 4b: Nodal Surcharge is increased to $0.226 per MWh effective March 1, 2009, per Docket No. 36412 settlement.
- Options 4a and 4b: On January 1, 2010, Nodal Surcharge is set at a level consistent with the projected System Administration Fee for 2010. The Nodal surcharge then remains constant until all remaining costs incurred by ERCOT to implement the nodal market are fully recovered.
- Nodal surcharge level – 2010 to full recovery of Nodal Program costs: $0.473 per MWh.

Options 5a and 5b: 100 percent revenue funding options

- Option 5a: Nodal Surcharge of $0.169 per MWh remains in effect through December 31, 2009.
- Option 5b: Nodal Surcharge is increased to $0.226 per MWh effective March 1, 2009.
- Options 5a and 5b: – On 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.
- Nodal surcharge level 2010 to full recovery of Nodal Program costs: $1.315 (Option 5a) or $1.264 (Option 5b) per MWh.

Further details underlying each option are reflected in Table 2 below:

Table 2: Nodal surcharge options.

Options presented to ERCOT Board ($ millions unless otherwise noted)	**No Change**	**Flat Fee**		**40% Revenue Funding**		**Rate Parity With SAF**		**100% Revenue Funding**	
	1	**2a**	**2b**	**3a**	**3b**	**4a**	**4b**	**5a**	**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 there-after	$0.226 through 2009; $0.473 there-after	$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	$ 77.7	$ 75.4	$ 64.1	$ 61.0	$ 38.9	$ 68.0
Costs recoverable via Nodal Surcharge	$ 672.4	$ 618.9	$ 616.1	$ 604.1	$ 601.8	$ 590.5	$ 587.4	$ 565.3	$ 564.4
Expected Nodal Surcharge – 2009 ($/MWh)	$ 0.169	$ 0.169	$ 0.169 $ 0.226	$ 0.169 $ 0.226	$ 0.169	$ 0.169	$ 0.169 $ 0.226	$ 0.169	$ 0.169 $ 0.226
Expected Nodal Surcharge – 2010 thru full recovery ($M/Wh)	$ 0.169	$ 0.285	$ 0.273	$ 0.335	$ 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	3 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. 2010	344.7 Dec. 2010	331.7 Dec. 2010	315.7 Dec. 2009	327.4 Dec. 2009	327.4 Dec. 2009	311.4 Dec. 2009	327.4 Dec. 2009	311.4 Dec. 2009
Percent revenue funding during development	27.1%	34.5%	37.0%	40.0%	40.2%	46.5%	49.7%	100%	100%

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

A. No. As in prior Nodal surcharge proceedings, ERCOT remains indifferent as to how the surcharge should be allocated among Market Participants. In Docket No. 32686, the Commission held that the Nodal surcharge "should be allocated to generation, as PURA 39.151(e) allows ERCOT to charge rates to both wholesale buyers and sellers to cover costs."[8] As long as the allocation methodology contemplates a billing relationship between ERCOT and QSEs (as opposed to ERCOT and other categories of entities), ERCOT is capable of formulating systems changes necessary to implement the Commission's allocation determination, and ERCOT does not have a preference regarding the allocation of costs "between wholesale buyers and sellers" for purposes of fee allocation. Any allocation methodology outside of the billing relationship between ERCOT and QSEs would have to address credit issues and other fundamental business process issues, as well as extensive information technology system implementation issues. As ERCOT has stated in previous discussions of this issue, ERCOT's interest lies in the implementation of the allocation methodology chosen by the Commission rather than in the choice of the methodology.

[8] Docket No. 32686, *Application of The Electric Reliability Council of Texas For Approval of A Nodal Market Implementation Surcharge And Request For Interim Relief*, Interim Order at 5 (Aug. 29, 2006).

Q. WHAT ACTIONS DID THE ERCOT BOARD OF DIRECTORS TAKE ON THE NODAL SURCHARGE OPTIONS?

A. The ERCOT Board of Directors first considered the Nodal surcharge options at its February 17, 2009 meeting. After discussion, the Board authorized ERCOT to pursue Commission approval of a revised surcharge based on Option 2. The Nodal surcharge resulting from use of Option 2 is close to that which the parties to Docket No. 36412 had agreed to in the Settlement Agreement filed in that docket. The Board determined that requesting a surcharge at this level represented a reasonable approach to seeking Commission approval of a revised Nodal surcharge.

Q. DID THE BOARD OF DIRECTORS RECONSIDER ITS DECISION AT ITS MARCH 2009 MEETING?

A. Yes. Between the February and March Board meetings, ERCOT received feedback on Nodal financing strategies from the Commission at its February 26, 2009 Open Meeting. As I noted earlier, the Commission urged ERCOT to adopt a financial policy that would return the organization to a policy to equity (revenue) fund at least 40% of project budgets and expressed concern about the amount of debt involved in completing the Nodal Program given the surcharge level adopted by the Board of Directors. ERCOT staff worked with the Finance and Audit Committee to address these concerns in a timely fashion. At the March 2009 Board meeting, ERCOT staff presented the revision to the Financial Corporate Standard discussed earlier in my testimony. The revised Financial Corporate

Standard also required that the Nodal surcharge recommendation be reconsidered by the Board of Directors.

Q. WHY WAS RECONSIDERATION OF THE NODAL SURCHARGE REQUEST REQUIRED?

A. Reconsideration of the Nodal surcharge was required in order to keep Nodal Program financing consistent with the requirement to equity (revenue) fund at least 40 percent of project budgets as per the revised ERCOT Financial Corporate Standard. In February 2009, the Board opted for Option 2. However, ERCOT does not expect that Options 1 or 2 detailed above would achieve the desired minimum equity (revenue) contribution level of 40 percent by the "Go-Live" date. Options 3, 4 and 5 are expected to result in an equity (revenue) contribution of 40 percent or more by the "go-live" date. ERCOT could not simultaneously comply with the requirement in the Financial Corporate Standard and go forward with the Nodal surcharge level the Board selected in February. The Board of Directors recognized this issue and reconsidered the five Nodal surcharge options presented in February. After considering the options, the Board selected Option 3, which is specifically calculated to attain a 40 percent revenue contribution of Nodal Program budget costs by the "Go-Live" date.

Q. DOES OPTION 3 REPRESENT A REASONABLE APPROACH TO FUNDING THE NODAL PROGRAM?

A. Yes. As ERCOT's Chief Financial Officer, I am committed to careful stewardship of the ratepayer funds entrusted to ERCOT, particularly in these uncertain economic times. The Nodal surcharge request approved by the Board of Directors enables ERCOT to achieve its target project equity (revenue) contribution level, continue to attain the benefits of reasonable debt financing, and strikes a fair balance between minimizing Nodal Program financing cost and keeping the surcharge at a reasonable level. In addition, ERCOT proposes that the increase in the Nodal surcharge proposed in Option 3a, adjusted based on the implementation date of the interim rate, as set forth in Table 1 above, if any, up to the surcharge rate of $0.375 in Option 3b not be implemented until January 2010. This lag time will give Market Participants enough time to include the new Nodal surcharge in their financial models and plans for 2010 and beyond.

Q. HAS ERCOT ANALYZED THE IMPACT ON IT FINANCIAL PICTURE OF CHANGING ITS FEDERAL TAX STATUS TO BECOME A § 501(c)(3) TAX-EXEMPT ENTITY?

A. Yes. While this investigation is not the subject of my testimony in this docket, the Commission has recently requested analysis of this issue in conjunction with its consideration of ERCOT financial issues related to the Nodal Program. I have attached to my testimony as Exhibit SB-3 a summary of the status of ERCOT's analysis of this issue.

V. CONCLUSION

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

A. Yes, it does.