Date: February 10, 2009
To: Board of Directors
From: Steve Byone, Vice President and Chief Financial Officer
Subject: Nodal Surcharge and Debt Financing

Issue for the ERCOT Board of Directors

ERCOT Board of Directors Meeting Date: February 17, 2009
Agenda Item No.: 11a

Issue:
If, consistent with Agenda Item 8c (Nodal Budget and Schedule) of the Board of Directors (Board) Meeting on February 17, 2009, additional spending authority is granted by the Board for further work on the Texas Nodal Market Implementation Program (Nodal Program), then ERCOT will need to establish a funding source consisting of revenue and/or debt to fund the increased spending.

Specifically, ERCOT seeks Board 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 rate consistent with directives provided by the Board during its February 17, 2009 meeting, including that such rate change be effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered; 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 requests 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.

Background/History:
In September 2003, as part of Project No. 26376, the Commission instructed ERCOT to replace its existing zonal wholesale market design with a nodal design. ERCOT began work on the Nodal Program once the Commission approved the Nodal Protocols during April 2006 in Docket No. 31540. Since that time, ERCOT has pursued completion of the Nodal Program. However, in May 2008, ERCOT notified the Board and the Commission that it would not be able to complete the Nodal Program by the January 1, 2009 deadline set by the Commission. Since May, ERCOT has continued work on the Nodal Program, while working with the Commission, the Board, and Stakeholders to evaluate the Nodal Program's status and plan for its completion. Under Agenda Item 8c (Nodal Budget and Schedule) of the Board of Directors (Board) Meeting on February 17, 2009, ERCOT is requesting the Board to approve additional spending authority for the Nodal Program and a revised schedule for completion.

ERCOT considered several factors in determining the funding options to fund the proposed Nodal Program spending increase. Current credit market conditions are a significant factor

influencing the choice of funding mechanisms for this spending increase. Notably, global credit markets within which borrowers and lenders operate have experienced almost unprecedented turmoil in the final months of 2008. Markets are beginning to recover but remain fragile; small shocks have the potential to cause major dislocations and markets are still far from liquid. ERCOT was successful in obtaining additional debt capacity in late 2008; however, it was significantly more difficult and more costly than it was a year before.

In addition to credit-market dynamics, ERCOT considered:

1) Its current debt load. ERCOT has already borrowed over $200 million to fund Nodal Program costs in addition to borrowings to fund other capital expenditures.
2) The need to preserve borrowing capacity for unexpected future needs. Further debt funding to support the Nodal Program will deplete credit capacity of lenders interested in making loans to ERCOT. Maintaining credit sources to address potential future borrowing needs for unexpected events is prudent.
3) Increased Nodal Program cost due to interest expense. The combination of potentially higher Nodal Program debt levels together with recent increases in borrowing costs add to the overall costs of the program.
4) Matching of the payment for the Nodal Program via the Nodal Surcharge with the benefit from the Nodal Program once it is in place.
5) Desire to minimize "spiking" in the Nodal Surcharge. The need or desire to have a consistent, predictable fee that will not fluctuate significantly.

Given these considerations, ERCOT developed five basic funding options for Board consideration. These options are based on the following key assumptions:

General Assumptions

- Nodal Program costs to be financed through the Nodal Surcharge of $526.4 million (excludes financing costs and interdependent projects)
  - Total cost $ 658.7
  - Less: Financing cost – (assuming Option 2a) 92.6
  - Less: Interdependencies 39.7
  - Net costs to be financed – Nodal Surcharge $ 526.4
- Average interest rate for debt financing is 6%
- Average useful life of assets is four years (three year life for hardware and a five year life for software)
- Revised Nodal Surcharge effective January 1, 2010
- Nodal market "Go live" by December 31, 2010

Spending Projection and Billing Determinant

	Total	Life to date 12/31/08	2009	2010	2011	2012	2013	2014	There after
Nodal Program spend by year ($ millions)	526.4	281.0	155.6	89.8					
GWh assumption (million MWh)			319.4	324.8	331.9	339.2	345.6	351.3	358.3

Option-Specific Assumptions:

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

The funding options are as follows:

	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
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.

ERCOT staff does not consider Option 1, the "No Change" option, to be consistent with previously stated financing goals, but included it for comparison purposes.

ERCOT believes that the scenarios shown in options 2 – 5 can be financed with the following caveats:

– The plan is approved by the Commission;
– Credit markets do not deteriorate; and
– No significant unexpected borrowing needs arise.

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 rate. To determine funding options, ERCOT considered credit-market conditions, current ERCOT debt levels, the need to preserve financial flexibility, matching of payments to the benefits of the Nodal Program and minimizing "spiking" in the Nodal Surcharge.
- Board approval is required to borrow money to fund Nodal Program spending in excess of the concurrent revenue received from the approved Nodal Surcharge.

Alternatives:

A. 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 make a filing with the PUCT seeking a deferral of Nodal debt repayment that had been scheduled to begin in 2009 as contemplated in prior Commission filings and also:

(a) an increase in the Nodal Surcharge rate consistent with Option 2a or 2b, effective as soon as practicable with such rate remaining in effect until all Nodal Program costs are recovered;

(b) 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;

(c) 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;
(d) 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
(e) 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.

B. Suspend all Nodal Program expenditures upon reaching previously authorized spending levels.

Conclusion/Recommendation:

ERCOT respectfully requests that the Board 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 to make a filing with the Commission, to request an increase in the Nodal Surcharge rate consistent with one of the options discussed above.

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", specifically, Option 2 as identified in the materials included with this Agenda Item of the Board meeting on February 17, 2009 (Flat-Fee Option). For purposes of the not-to-exceed amount above, an interest cost estimate of $92.6 million was assumed.

WHEREAS, the Finance and Audit (F&A) Committee of the Board recommended that the Board approve the Flat-Fee Option;

THEREFORE, BE IT RESOLVED, the Board hereby accepts the recommendation of the F&A Committee and approves the revised Nodal Program budget of a total amount not to exceed $658.7 million and finds that this is a reasonable forecast of ERCOT's costs of nodal market implementation; and

RESOLVED FURTHER, the Board authorizes ERCOT to make a filing at 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 the Flat-Fee Option 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.

ERCOT

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 voice vote of twelve in favor, three opposed (Messrs. Dalton, Ballard and Fehrenbach) and no abstentions.

IN WITNESS WHEREOF, I have hereunto set my hand this 25th day of February, 2009.

Michael G. Grable
Corporate Secretary