

**ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.
MINUTES OF THE FINANCE & AUDIT COMMITTEE – SPECIAL MEETING**

2010 Budget Review and Public Comment
7620 Metro Center Drive (Room 206) – Austin, Texas 78744
August 17, 2009

Pursuant to notice duly given, the Finance & Audit Committee of the Electric Reliability Council of Texas, Inc. (“ERCOT”) convened on the above-referenced date. Clifton Karnei confirmed that a quorum was present and called the meeting to order at approximately **2:08 p.m.**

Special Meeting Attendance

Committee Members:

Ballard, Don	Office of Public Utility Counsel	Residential Consumer	Present
Cox, Brad	Tenaska Power Services	Independent Power Marketer	Present
Espinosa, Miguel (Vice Chair)	Unaffiliated Board Member	Unaffiliated Board Member	Present
Gent, Michehl	Unaffiliated Board Member	Unaffiliated Board Member	Present
Jenkins, Charles	Oncor Electric Delivery Company	Investor Owned Utility	Not Present
Karnei, Clifton (Chair)	Brazos Electric Power Cooperative	Cooperative	Present
Thomas, Robert	Green Mountain Energy Company	Independent Retail Electric Provider	Not Present
Wilkerson, Dan	Bryan Texas Utilities	Municipal	Present

Other Board Members and Segment Alternates:

Armentrout, Mark	Unaffiliated Board Member	Unaffiliated Board Member	Present
Bartley, Steve	CPS Energy	Municipal	Present
Brown, Deryl	Hudson Energy Services	Independent Retail Electric Provider	Present
Dalton, Andrew	Valero Energy Corp.	Industrial Consumer	Present
Helton, Bob	International Power America	Independent Generator	Present
Newton, Jan	Unaffiliated Board Member	Unaffiliated Board Member	Present
Patton, A.D.	Unaffiliated Board Member	Unaffiliated Board Member	Present
Ryall, Jean	Constellation Energy	Independent Power Marketer	Present
Smitherman, Barry	Public Utility Commission of Texas	PUC Chairman	<i>Via telephone</i>
Walker, Mark	NRG Texas	Independent Generator	Present

ERCOT Staff and Guests:

Anderson, Troy	ERCOT – Manager, Program Administration
Barry, Sean	PricewaterhouseCoopers
Byone, Steve	ERCOT – Vice President and Chief Financial Officer
Capezzuti, Nancy	ERCOT – Vice President and Chief Administrative Officer
Cleary, Mike	ERCOT – Senior Vice President and Chief Technology Officer
Day, Betty	ERCOT – Director, Markets
DiPastena, Phil	ERCOT – Enterprise Risk Manager
Doggett, Trip	ERCOT – Senior Vice President and Chief Operating Officer
Donohoo, Ken	Oncor Electric Delivery Company
Dreyfus, Mark	Austin Energy
Gillmore, Gina	ERCOT – Senior Financial Analyst
Goff, Eric	Constellation New Energy
Grable, Mike	ERCOT – Vice President and General Counsel
Hancock, Misti	ERCOT – Manager, Budget and Financial Analysis
Headrick, Bridget	Public Utility Commission
Kahn, Bob	ERCOT – President and Chief Executive Officer
Kleckner, Tom	ERCOT – Nodal Communications Strategist
Lester, Suzanne	ERCOT – Executive Assistant, Finance
Manning, Chuck	ERCOT – Vice President and Chief Compliance Officer
McClendon, Shannon	Law Offices of Shannon McClendon
Morais, Matt	ERCOT – Assistant General Counsel
Morehead, Juliana	ERCOT – Associate Corporate Counsel
Morgan, Richard	ERCOT – Vice President and Chief Information Technology Officer
Ogelman, Kenan	CPS Energy
Petterson, Mike	ERCOT – Controller
Roark, Dottie	ERCOT – Manager, Corporate Communications
Saathoff, Kent	ERCOT – Vice President, System Planning and Grid Operations
Seibert, Dave	ERCOT – Senior Legal Specialist
Stauffer, Tarra	ERCOT – Legal Assistant
TroxteLL, David	ERCOT – Director, PMO
Wullenjohn, Bill	ERCOT – Director, Internal Audit
Yager, Cheryl	ERCOT - Treasurer

Overview of 2010 Budget

Bob Kahn provided the Finance and Audit Committee (“Committee”) with an overview of the proposed 2010 budget and requested that the Committee view the materials provided to them prior to meeting. Mr. Kahn spoke of the difficult economic times and ensured the Committee that he is committed to work to keep the fee as flat as possible, while maintaining reliability. He informed the Committee that the proposed 2010 budget and its three options would be presented during this meeting, and subsequent approval of a 2010 budget should be expected in September 2009. Mr. Kahn informed the Committee that he considered the following impacts, benefits, and challenges in preparing the 2010 budget:

- (1) Maintaining reliability;
- (2) Maintaining a robust retail market;
- (3) Progressing towards a Nodal market;
- (4) Implementing advance metering;
- (5) Planning efforts relating to the integration of renewables into the grid;

- (6) Complying with NERC requirements; and
- (7) Keeping up with smart technology.

Mr. Kahn highlighted the Competitive Renewable Energy Zone study ("CREZ study"), and mentioned that Texas has one of the most successful deregulated markets in the world. He then addressed the "need" challenges that ERCOT faces in 2010, such as (a) the ability to manage advance metering data for up to six million customers, (b) employing adequately skilled staff to ensure compliance with NERC requirements (which are expected to exceed 34,000 hours of preparation) and (c) planning around renewable energy (i.e., the "horsepower issue") and the impact on the electric grid.

The 2009 approved budget was referenced as it relates to controlling costs, the January 2009 approved flat fee, decreased headcount, and reduction of training, development, and business expenses. Mr. Kahn reminded the Committee that the March 2009 revenue shortfall steps were designed to reduce expenses. Furthermore, Mr. Kahn informed the Committee that ERCOT had undertaken the following tasks to cut costs: (a) renegotiating hardware and software licenses; (b) reducing debt and the costs associated therewith; (c) undergoing a hiring freeze; (d) delaying or eliminating capital projects and reducing other expenses equaling \$5.7M in cuts; and (e) continuing to watch and evaluate expenses on a monthly basis. He informed the Committee that the aforementioned tasks taken by ERCOT were just starting points for preparation of the 2010 budget.

Mr. Kahn directed the Committee to meeting handouts enumerating the three 2010 budget options for consideration:

- (1) 2010 Management Recommendation - eliminates 23 positions relative to the preliminary budget and unchanged core and non-core services
- (2) 2010 Moderate Service Reduction - eliminates 31 additional positions, unchanged core service levels and degradation or elimination of some non-core services
- (3) 2010 Flat Revenue Requirement - eliminates 48 additional positions and degradation or elimination of some core and non-core services

The remainder of Mr. Kahn's presentation focused on two projects impacting the 2010 budget by \$7.6M, ERCOT's five-year forecast, and task analyses of the proposed 2010 budget.

Mr. Kahn enumerated the necessity for expenditures in Data Center equipment and completion of the MET Center project. ERCOT has been near capacity with its Data Center equipment since 2003, Mr. Kahn said. He went on to explain that such equipment should be replaced every five years due to changes in technology and the decrease in reliability of the equipment with age. The issue of physical security at the MET Center was then addressed, followed by Mr. Kahn informing the Committee that a significant "scrub" was made to the Zonal projects, which allows only critical Zonal projects to move forward.

In addressing ERCOT's five-year forecast, Mr. Kahn accentuated the need for defect resolution and for critical enhancements. Mr. Kahn also briefly mentioned the need for a parking deck. He then discussed the implications of Nodal Go-live and the 2011 budget review process. Mr. Kahn informed the Committee that ERCOT undertook a Deep Dive Task Analysis, which resulted in some functions being combined and gaining some efficiencies, but that ERCOT needed to do more. Therefore, he said, in preparation for 2011 and Nodal Go-live, ERCOT

needed to start with a clean slate while focusing on statutory and PUC mandates, such as the REC program and funding the market monitor, consideration of the challenges facing ERCOT relating to renewables and the "smart grid", and to carefully review the associated costs. Mr. Kahn also recommended the reduction in Board of Directors and Committee meetings, the question and answer session prior to board meetings and the elimination of the annual Board Retreat to cut down on costs.

In closing, Mr. Kahn assured the Committee that he and ERCOT take the state of the economy very seriously, and will diligently work to keep a flat fee, but in order to meet the challenge ERCOT needs adequate resources to carry out the reliability functions of ERCOT.

Review by Spending Category and Five-Year Forecast

Mike Petterson reviewed the 2010 budget by spending category and discussed the five-year forecast. He began by restating ERCOT's obligation to carry out reliability of its services to the state of Texas in an efficient and effective manner. Mr. Petterson outlined large critical areas affecting the 2010 budget including, Nodal implementation, protocol compliance, and the maintenance of a 60/40 debt equity ratio for capital spend funding.

Mr. Petterson continued the discussion by focusing on cost recovery methodology for the System Administration Fee billing determinate change. He fielded questions regarding staffing and outlined headcount growth, salary administration, benefit and tax load, reward, recognition, and vacancy savings. Mr. Petterson went on to speak about contractor labor for Nodal, base projects, and employee expenses and allocations. He concluded this discussion by drawing attention to outside services, hardware and software support, interest expense, capital spending (as outlined in Project Priority List materials), and smaller categories such as weather subscriptions, sponsored meeting space, recruiters, printing, and postage.

Thereafter, Mr. Petterson reviewed the three budget options presented in the 2010 budget. In response to the first option (2010 Management Recommendation), Mr. Smitherman asked if the elimination of 23 positions would be a net reduction since the addition of 23 new positions had been discussed earlier in the year. Mr. Smitherman inquired as to whether ERCOT feels it can now work without said 23 positions. Mr. Kahn responded to Mr. Smitherman's inquiry by stating that he viewed the addition/reduction analogy as more of a rebalancing of force. Mr. Smitherman voiced his concern that if the figures were netted out, the numbers would not be cumulative. Messrs. Kahn and Petterson agreed that the information was ill defined in the budget analysis as presented, and promised to correct the data.

Mr. Smitherman then inquired as to the degradation and/or elimination of core services in the 2010 Flat Revenue Requirement option, and asked about the types of services that would fall into these cuts. Mr. Smitherman commented that by definition, "core services" are such that should not be degraded and/or eliminated, and therefore the 2010 Flat Revenue Requirement option should not be an option. Mr. Kahn replied that the 2010 Flat Revenue Requirement option is not recommended.

Mr. Petterson moved his discussion towards the 2010 Budget and Financial Forecast by highlighting the following line items: (1) Operating Expense; (15) Revenue Funded Capital in the 2010 Proposed Budget; and (23) Debt Services Principal.

Michehl Gent asked whether the market monitor line item was in the legislative realm. It is Mr. Petterson's understanding that it was by contract. Mr. Petterson continued by leading a lengthy

discussion concerning revenue necessities. Clifton Karnei asked if the \$2.4 million in variance for 23 new full-time employees working on Nodal compliance and facilities as posed under "Additional Work Requirements (Task Analysis)" were related to the 23 positions listed as eliminated under the 2010 Management Recommendation option. Mr. Karnei added that if 23 positions were added, there would have to be a decrease somewhere to stay at the 739-person headcount. Mr. Petterson responded that there was a deduct line item for the percentage of time spent on projects and only the net was reflected in the budget materials. He said ERCOT is looking at areas of other revenue sources. Mr. Petterson concluded by pointing out that the total net cost increase listed in the materials as \$10.1M is up by \$2.5M from 2009.

Miguel Espinosa expressed concern regarding the confusion of the elimination of 23 employees under the 2101 Management Recommendation option. Mr. Petterson reassured Mr. Espinosa that the corrected data would provide the Committee with a more adequate description of the options, and would be disseminated to them at a later date.

Michehl Gent requested more details regarding the percentage of employee medical benefits.

Dr. Patton inquired into mandated costs by outside parties such as webcasts and POLR. Mr. Petterson responded that most said costs are captured under "Outside Services" in the 2010 budget preview. Mr. Espinosa suggested that ERCOT identify items that do not add to electric reliability. Jan Newton summarized that if she is interpreting the data correctly, the \$2.5M increase over 2009 was driven by Data Center and hardware/software requirements that the Board has determined critical to electric reliability.

In moving on with the discussion, Deryl Brown asked about decreased Zonal spending and expressed concerns of an increased risk congestion. Trip Doggett verified that no Zonal projects related to congestion management are being terminated. Don Ballard further responded that there should be no degradation of Zonal support that would cause reliability to suffer.

A few questions were posed regarding the high costs for labor. Mr. Petterson stated he would provide more information to the Finance and Audit Committee regarding the 23 positions highlighted in the 2010 Management Recommendation option. He added however, that ERCOT had to factor in results from turnover and the time it takes to fill a position. Dr. Patton commented that if staff were cut, a number of employees would vacate positions, which is a considerable risk to ERCOT's determination to preserve reliability. Bob Kahn agreed that there is a risk of additional employees leaving because of layoffs.

Mr. Petterson stated that the proposed budget forecast assumes a flat load, and that in 2015, a 6-cent per MWH impact on load growth to 350M MWHs can be expected. Jan Newton commented that a net reduction should be seen due to a decrease in work. Mr. Karnei then asked if the forecast included the Sunset Review cost. Mr. Petterson responded that the budget forecasts \$750,000.00 in Sunset Review expense.

Mr. Petterson gave a brief overview of the debt forecast. He covered the 2010 headcount and FTE Equivalency, and directed the Committee to meeting materials covering the 2010 Project Priority List. Mr. Smitherman mentioned that he would like to see more details on the debt repayment and information related to the Nodal program. Jan Newton followed up by stating that the challenge would be the Nodal and Zonal budgets coming together.

Divisional Review of Key Services and Cost Containment Measures

Mr. Doggett gave the first divisional reviews regarding the ERCOT Operations group. He reviewed recent organizational efficiency changes. Mr. Doggett then outlined his current organization and informed the Committee that his 2009 organizational budget was approximately \$33.9M. He provided information regarding growth for ERCOT as well as in his area. Specifically speaking, Mr. Doggett noted that ERCOT has had a personnel growth of 163 employees since 2006, 75 of which are/were employed in the Operations group. Mr. Doggett discussed several factors for consideration as the Board reviews the 2010 budget options. Such considerations include: (1) the need for "study horsepower" and wind integration; (2) Nodal support (112 FTEs in Nodal Budget); and (3) employee rate versus contractor rate in Nodal Project. He added that personnel who will operate Nodal are those who are building Nodal. Mr. Doggett further commented that to date, beyond the global reductions mentioned by Mr. Kahn, ERCOT's Operations group has identified cuts exceeding \$1.6M in 2009 alone. He said the cuts thus far have resulted from not filling budgeted positions, reducing budget for travel, training, expenses, and outside services. Mr. Doggett then gave examples of potential budget reductions for each of the three budget scenarios.

Dr. Patton commented that the cuts and/or reductions for engineering operations and planning concerned him.

Richard Morgan then presented a review of ERCOT's IT group. His discussion focused on operating expenses relating to ERCOT business functions, specifically, grid management, market services, general public services, PUCT/IIM services, and internal user services. Mr. Morgan provided a list of critical business, IT projects, and key milestones. He briefly talked about ERCOT's IT budget, comparing the 2009 budget to the 2010 Management Recommendation option, which provides for the addition of only one extra employee/contractor to the IT group. Mr. Morgan began listing the cost containment and efficiency actions, but due to time constraints, Mr. Karnei asked Mr. Morgan to yield to the remaining presentation.

Nancy Capezutti provided the Committee with an overview of ERCOT's Administrative function covering cost reduction and expenses for the 2010 budget. Ms. Capezutti briefly touched on the HR, PMO, and Facilities departments' structure, cost reduction, and expense control methods. She added that a new department would be working on strategic and organizational development plans.

Question and Answer Session

Due to time constraints, there was no designated question and answer session, though questions had been asked and answered during the Special Finance and Audit Committee Meeting.

Adjournment

Clifton Karnei adjourned the meeting at approximately 4:00pm.



Juliana Morehead
Associate Corporate Counsel