ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.
MINUTES OF THE FINANCE & AUDIT COMMITTEE (Room 206) – GENERAL SESSION

7620 Metro Center Drive – Austin, Texas 78744
August 18, 2009

Pursuant to notice duly given, the Finance & Audit Committee ("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 **7:35 a.m**. The Committee met in Executive Session from **7:35 a.m.** to **8:40 a.m.**, at which time it recessed to General Session.

General Session 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 Company	Investor Owned Utility	Not Present
Karnei, Clifton (Chair)	Brazos Electric Cooperative	Cooperative	Present
Thomas, Robert	Green Mountain Energy	Independent Retail Electric Provider	Not Present
Wilkerson, Dan	Bryan Texas Utilities	Municipal	Present

Other Board Members and Segment Alternates:

Bartley, Steve	CPS Energy	Municipal	Present
Brown, Deryl	Hudson Energy Services	Independent REP	Present
Crowder, Calvin	AEP Service Corporation	Investor Owned Utility	Present
Smitherman, Barry	Public Utility Commission	Chairman	Present
Walker, Mark	NRG Texas	Independent Generator	Present

ERCOT staff and guests present:

Adler, Amy	ERCOT – Supervisor, Internal Audit
Anderson, Troy	ERCOT – Manager, Program Administration
Baker, Randy	ERCOT – Director, Credit Risk Management
Barrow, Les	CPS Energy
Barry, Sean	PriceWaterhouseCoopers
Brenton, Jim	ERCOT – Director, Cyber Standards
Byone, Steve	ERCOT – Vice President and Chief Financial Officer
Cleary, Mike	ERCOT – Senior Vice President and Chief Technology Officer
Day, Betty	ERCOT – Director, Markets

Delenela, Ann	ERCOT – Director, Corporate Security
DiPastena, Phil	ERCOT – Enterprise Risk Manager
Doggett, Trip	ERCOT – Senior Vice President and Chief Operating Officer
Donohoo, Ken	Oncor Electric Company
Drost, Wendell	AREVA
Forfia, David	ERCOT – Director, IT Infrastructure
Gillmore, Gina	ERCOT – Senior Financial Analyst
Goff, Eric	Constellation New Energy
Hancock, Misti	ERCOT – Manager, Budget and Financial Analysis
Headrick, Bridget	Public Utility Commission of Texas
Howard, Richard	ERCOT – Director, IT Operations
Kahn, Bob	ERCOT – President and Chief Executive Officer
Kleckner, Tom	ERCOT – Nodal Communications Strategist
Lester, Suzanne	ERCOT – Executive Assistant, Finance
Magness, Bill	Casey, Gentz & Magness
Manning, Chuck	ERCOT – Vice President and Chief Compliance Officer
Morehead, Juliana	ERCOT – Associate Legal Counsel
Morgan, Richard	ERCOT – Vice President and Chief Information Technology Officer
Nield, James	ERCOT – Manager, Treasury
Petterson, Mike	ERCOT – Controller
Rocap, Nisha	PricewaterhouseCoopers
Saathoff, Kent	ERCOT – Vice President, System Planning and Grid Operations
Stauffer, Tarra	ERCOT – Legal Assistant
Steadman, Laura	ERCOT – Procurement Specialist III
Troxtell, David	ERCOT – Director, PMO
Walsh, Meg	ERCOT – Manager, Procurement
Wullenjohn, Bill	ERCOT – Director, Internal Audit
Yager, Cheryl	ERCOT - Treasurer

Approval of Prior Meeting General Session Minutes

Michehl Gent moved to approve the minutes for the General Session of the Committee meeting held on July 21, 2009. Calvin Crowder (Segment Alternate) seconded the motion. The motion passed by voice vote with no abstentions.

Approval of Engagement of External Auditor for Non-audit Services

Clifton Karnei stated that discussion regarding the engagement of external auditor/s was a reporting item only.

Mike Petterson informed the Committee that as required by the Committee's Charter, ERCOT staff must seek preapproval for non-audit services provided by ERCOT's independent, external auditor.

Mr. Petterson indicated he sought approval to renew subscriptions to an accounting literature database, Comperio, sold by PricewaterhouseCoopers – ERCOT's current external auditor. Information in the database is essential for accounting staff to keep abreast of authoritative accounting literature and to carry out their job responsibilities. Mr. Petterson added that ERCOT has subscribed to Comperio for the last four years and the annual cost has been around $2000 per year. Mr. Karnei attempted to elicit comments, questions, and concerns by the other members of the Committee, but none were made and no objections to the renewal of the subscription to the database service was raised.

PricewaterhouseCoopers SAS-70 Audit Update

Sean Barry and Nisha Rocap of PWC presented an update concerning their SAS-70 audit of ERCOT and directed the Committee to the Management Letter contained in the materials disseminated to the Committee prior to the meeting. Ms. Rocap reminded the Committee that as communicated at the April 22, 2009 Committee meeting, PWC did not identify any deficiencies in their SAS-70 audit of ERCOT. She then gave an overview of the SAS-70 process explaining that it is an examination of internal controls for market-based systems that are primarily used by auditors and market participants (specifically, SEC registrants). Ms. Rocap discussed the audit period of October 1, 2008 through September 30, 2009, stating that the Report was an interim report and PWC had completed half of the fieldwork with no findings of significant changes in scope. She added that Phase 1 included all controls tested at interim, and Phase 2 included all controls tested over the year. Ms. Rocap said the audit was on time and within the budget. Ms. Rocap summed up her overview by stating that she was merely presenting the Committee with interim findings, and reiterated that the audit project is on, and within budget, but for two exceptions, both of which Trip Doggett would explain in further detail.

Trip Doggett then took over stating that he would give the Committee a high-level overview of the two exceptions identified by Ms. Rocap.

> Exception 1: Mr. Doggett stated that annual Pre-assigned Congestion Rights ("PCR") allocation approvals included calculations to be approved by department managers. Due to reorganization however, Mr. Doggett stated that ERCOT lacks a functioning manager, but that findings up to present do not indicate impact upon the market or on settlements to undertake such approvals. He further said that ERCOT recalculated the pre-assigned revenue rights and received accurate results. Furthermore, he informed the Committee that ERCOT is implementing remedial actions to ensure proper functioning of the annual PCR allocation approvals. He assured the Committee that he and his division take this issue very seriously and as such, the staff has been briefed on the issue to ensure a culture of compliance.
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> Exception 2: Mr. Doggett added that there had been some issues with levels of security for exiting employees as applied to revoking access to ERCOT facilities (physical and technical). He noted that high-level access is timely removed, but that ERCOT has had issues involving adequate revocation of low-level access to databases. However, Mr. Doggett reassured the Committee that the security issue had been identified, and protocols were being created to ensure long-term fix by implementing automated detection processes. Moreover, he said that no impact to the market or settlements has occurred, yet ERCOT is diligently monitoring the situation until such automated processes are implemented.

Bob Kahn asked about the term "exception" and the difference between qualified exceptions and not qualified exceptions. Mr. Barry noted that when exceptions are identified, they are reported. He added that the identification of exceptions was a transparent process and important to readers. Mr. Kahn asked whether it was common to have no exceptions in an audit. Mr. Barry responded that having no exceptions is relatively uncommon. Mr. Barry then provided the timing for completion of the audit, and noted that Phase 2 should be completed in September/October 2009, with a final report and call to follow providing information to Market Participants.

Credit Briefing: Potential Future Exposure

Cheryl Yager introduced Randy Baker, the new Director, Credit Risk Management, and informed the Committee that Mr. Baker had prepared information on potential future exposure. Randy Baker directed the Committee to materials provided to them prior to the meeting, and gave an overview of the contents contained therein. Mr. Baker focused on Potential Credit Risk Model updates and noted that overall, t base case residual credit risk remained comparable to the level identified in the initial Oliver Wyman model (i.e., market factors have reduced risk, QSE factors have increased risk, and the net effect was that overall risk was slightly down). Mr. Baker added that current case residual credit risk increased when compared to the level identified in the Oliver Wyman model, specifically that excess collateral held has decreased, resulting in increased residual credit risk.

Mr. Baker continued his discussion by reminding the Committee that information on market credit risk is being provided as required by the Market Credit Risk Standard approved by the Board of Directors in May 2009. He added that his presentation was based on financial statement information provided by Qualified Scheduling Entities ("QSEs") as of December 31, 2008. In addition, Mr. Baker informed the Committee that the Potential Credit Risk Model ("Model") uses a Monte Carlo Simulation for potential credit losses across all ERCOT QSEs, while taking into account several risk factors such as default probabilities, exposure parameters, market price and price volatility, collateral, and the relationships between the factors. He said the Model is not a predictor of the future because it is not capable of encompassing every factor or scenario, but that it provides insight into what may happen along with the probability of various outcomes.

Mr. Baker then directed the Committee to a schematic of the Model and talked about the four modules contained within the Model (i.e., Default, Price, Volumetric, and Collateral), which are the key credit risk factors in the ERCOT market. He then went into more detail on base case, and current case, highlighting that: (a) collateral levels associated with base case is at least consistent with current protocols, but does not include current collateral held by ERCOT; and (b) current case uses current levels and forms of collateral for each QSE held by ERCOT at the beginning of a simulated period – i.e., it is a starting point that is based upon collateral at this point in time, and assumes that collateral over the simulation period does not fall below those levels even if exposure goes down.

Mr. Baker then presented the Histogram of Losses for the base case (page 16 of the Meeting materials) for 9,000 of 10,000 (or 90%) of the simulations done. The Histogram highlighted that 90% of these simulations generated credit losses of less than or equal to $7.8 million. Mr. Baker further explained that over 29% of the simulations had no losses, and over 70% resulted in losses of less than or equal to $1.7 million.

Mr. Karnei asked whether the $1.7 million was the net loss. Mr. Baker confirmed that the figure was the net loss after collateral was considered.

Albeit a rarity, Mr. Karnei asked if these events could occur in tandem with an extreme event (e.g., spiking gas prices, hurricane, etc) and further inquired into the method of accounting for such extreme events. Mr. Baker responded that although the Model does not directly consider specific disaster scenarios, the Model does provide for distribution of losses resulting from an extreme event affecting the marketplace and noted that he would discuss those later in the presentation.

Barry Smitherman asked how the Model could account for great disparity in the size of some market participants (e.g., where one market participant has credit difficulty and migration is required). Mr. Baker responded that, for each QSE (including the large QSEs), the Model links: (1) the volume of load/generation for that QSE; and (2) the default probability of the QSE.

Mr. Smitherman asked for more explanation concerning how default probabilities were determined. Mr. Baker responded that if a rating from a major credit rating agency is available, it is used in the analysis. Where an entity is not rated, Mr. Baker added that the Credit Scoring Model (a component of the overall Model) is used, which relies primarily on financial statement data and other criteria.

Mr. Smitherman inquired about the practicality of migrating customers to alternate providers in the event a large Retail Electric Provider ("REP") goes out of business. He further asked Mr. Baker if a scenario such as this was captured in his analysis. Mr. Baker replied that the Model uses some base assumptions about escalation of volume, the balancing of the market, and the time required to migrate customers

Mr. Smitherman asked who designed the Model. Ms. Yager noted that the Model was developed by ERCOT and Oliver Wyman, and was vetted by the credit work group. She also clarified that, for simplicity, the Model treats load serving entities (LSEs) as either large or small. In default scenarios, the Model assumes small LSEs will Mass Transition their customers using the timeline used in the market. The Model does not assume that large LSEs will do a Mass Transition but will rather find another way to resolve their default (e.g. bankruptcy, etc).

Mr. Karnei noted that when a QSE files for bankruptcy, collateral held at the time of the bankruptcy would apply to its pre-petition exposure amounts owed to ERCOT. However, he continued, that entity would have to post additional collateral for its post-petition exposure and stay current on those payment responsibilities. Ms. Yager agreed with Mr. Karnei and noted that stress tests could be run on the Model using more extreme assumptions if needed.

Mr. Smitherman added that in the spring of 2003, he recalled the market absorbing around $15 million in losses. Ms. Yager responded that in that particular instance, the entity ultimately liquidated under Chapter 7 and transitioned its customers. Mr. Smitherman noted that it might be advisable to have a bankruptcy attorney confirm the reasonableness of ERCOT's assumptions used in the Model. Mr. Karnei asked Ms. Yager to research this idea and return to the Committee with the information.

Mr. Cox asked whether ERCOT staff had a plan to handle one of the aforementioned scenarios. Ms. Yager replied that ERCOT's Settlement Department has a plan, developed with the market, which could be provided to the Committee at a future meeting, if desired. Mr. Kahn mentioned that he challenged Betty Day's group to see how many customers ERCOT could provide services to in the event of a large Mass Transition. At present, Mr. Kahn noted that ERCOT is able to process 150,000 customers per day. Discussion followed regarding the issue of the market's ability to absorb the 150,000 figure and Ms. Day confirmed that market participants had noted that they would be able to absorb this level of transition. In summation, Mr. Karnei noted that although there would be a high probability of some level of default, the true issue was the number and figure over a year, to which Mr. Baker concurred.

Mr. Baker went on to review changes since the 2008 fiscal year end. He discussed tail risks (i.e., extreme events) tied to the base case and highlighted factors and drivers of the Model citing a slightly decreased risk on the base case. Mr. Baker added that as new QSEs with low credit quality enter the market or as existing QSEs credit quality deteriorates, credit risk increases.

Mr. Baker then outlined current case simulations using Guarantor's PD and Group Logic approaches. Although the difference in losses was not significant between the approaches, when comparing confidence levels of 95% or less, with confidence levels above 95%, the Guarantor PD approach indicated significantly higher potential losses.

Mr. Karnei inquired into the comparison of expected losses and commented that he did not consider the difference between the expected loss numbers large. Mr. Baker responded that expected losses did not vary significantly. Mr. Baker concluded by briefly talking about a change made to the Model to adapt for negative prices in the West zone (only a slight effect), price correlations (updated as market prices change with each period), and Model resource research and undertakings. He also noted that ERCOT was examining options for running the Model more frequently. Mr. Karnei expressed appreciation for Mr. Baker's report and explanations.

Discussion of Recommended 2010 Base Operating Budget

Mr. Karnei noted the Special Committee Meeting on the prior day for review of the 2010 budget options. Mr. Karnei added that the Committee discussed the budget options at length in Executive Session, and mentioned that he had conducted an initial poll of Committee members for insight into what budget option the Committee might recommend to the Board. He stated that the Committee had questions that required staff clarification before the Committee could finalize its recommendation. However, Mr. Karnei pointed out, the consensus during the Executive Session suggested that the Committee would likely recommend the 2010 Management Recommendation budget scenario (as defined in the materials disseminated to the Committee) to the Board in September 2009. He added that additional information and details regarding the three budget options would be provided the following day at the August Board of Directors meeting.

Standing Investment Update

Cheryl Yager directed the Committee to materials provided to them prior to the meeting. Ms. Yager began by stating that she was updating the Committee on investments in response to concerns expressed by Committee members. She informed the Committee that ERCOT has added Evergreen and AIM as investment accounts (two accounts with each fund family). She said ERCOT is still testing the transaction system with AIM. She added that there is currently approximately $180 million in investable funds; however, planning for investable funds in the zonal market should consider investable funds of up to around $400 million since ERCOT held around $360 million in investable funds at December 31, 2008. . Ms. Yager mentioned that she would provide the Committee with a Nodal related investment update in the near future. Mr. Cox expressed the importance of addressing investment strategy. Ms. Yager explained that ensuring ERCOT had timely access to funds to maintain liquidity was a priority for ERCOT staff. She directed the Committee to the materials that provided analyses of different options, noting that the Committee had considered the same information earlier in the year, but had not made a decision given the financial market constraints at that time. Now that investment options were opening up, she asked for further guidance from the Committee on investment strategy.

Mr. Karnei said that previously Mr. Cox asked about outsourcing options to alleviate the possible administrative burden of an increased number of funds, to which Mr. Cox replied that he was satisfied with the current investment situation, but wanted to continue to diversify without being exposed to outside conflicts or internal burdens. Steve Byone addressed the Committee and asked for further feedback on the number of funds and specific fund targets to be considered. .

The issue of further diversification was initiated by Mr. Cox. Ms. Yager noted that with Money Market funds as the primary investment vehicle, having something like four funds provided a level of liquidity diversification and was manageable with existing staff. She added that staff would be glad to implement whatever strategy the Committee desired, but noted that further diversification, expansion of investment options or more complex structures would require additional staff to manage. Discussion of percentage and dollar caps on funds was discussed.

The issue of yield was introduced by Mr. Smitherman. Mr. Smitherman suggested the Committee consider the outlook for Treasury and Treasury-backed investments, and further explore options such as state and tax-exempt bonds or legitimate triple A securities. He added that the Committee should ask itself if there a reasonable balance of credit risk, liquidity and return. He further asked the Committee if it wanted to continue focusing on maximum liquidity and maximum security.

Mr. Karnei referred to a time when the Committee looked at highly rated prime funds with a yield focus that allowed movement between funds and adjustment of risk. He noted that when ERCOT had problems with its investments at The Reserve and given the overall market credit situation over the past year, the pendulum swung towards the decision to go with only Treasury or Treasury-backed securities. Mr. Karnei added that the Committee should think about the balance currently being maintained between safety, liquidity, and return. Thereafter, Mr. Karnei asked Ms. Yager to bring this issue back for future discussion.

Mr. Espinosa expressed agreement with Mr. Smitherman's comments regarding challenges, and asked Ms. Yager to provide the Committee with a range of available vehicle rates and yields to allow the Committee to evaluate investment possibilities. He further stated that it was his belief that ERCOT needed a dollar cap on each fund, and would like to be presented with information regarding such at the next Committee meeting. Mr. Ballard then stated that he wanted ERCOT to continue to invest market participant deposits in Treasury and Treasury-backed securities, unless market participants are willing to absorb the risks associated therewith.

Michehl Gent inquired into the data regarding future and additional investments as contained in the Summary of Investments as of August 10, 2009, and recommended a soft cap of some kind. He added that he liked the distribution contained therein. Ms. Yager concluded the discussion by noting that she would bring back additional information at a future meeting.

Committee Briefs

Materials distributed prior to the Committee meeting focused on the following areas:

1. Market Credit
2. Internal Control Management Program ("ICMP")
3. Enterprise Risk Management ("ERM")
4. Project Management Organization ("PMO")

Future Agenda Items

The following items were identified as future agenda items:

1. Standing Internal Audit agenda items

2. Short list recommendation of independent auditors (Financial Audit and SAS-70 Audit)
3. Review of the F&A Committee Charter
4. Review and assessment of compliance and internal control systems
5. Update of the 2009 financial forecast
6. Possibility of a Special Meeting for external auditor review
7. Recommending a 2010 Base Operating Budget
8. Standing Investment update
9. Committee briefs
10. Future agenda items

Mr. Smitherman asked Mr. Karnei if he would be communicating a 2010 budget recommendation at the General Session Board Meeting, and Mr. Karnei reiterated that he would be informing the Board that further clarification regarding the budget options was needed, but the consensus was such that the Committee would likely recommend the 2010 Management Recommendation budget option at the September 2009 meeting.

Adjournment

Clifton Karnei adjourned the meeting at approximately 10:00 a.m.

Juliana Morehead
Associate Corporate Counsel