

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

7620 Metro Center Drive (Room 206) – Austin, Texas 78744
July 20, 2010

Pursuant to notice duly given, the Finance & Audit Committee ("Committee") of Electric Reliability Council of Texas, Inc. ("ERCOT") convened on the above-referenced date. Committee Chairman Clifton Karnei confirmed that a quorum was present and called the meeting to order at approximately 8:00 a.m. The Committee immediately went into Executive Session, where it remained until it recessed and reconvened in General Session at 9:05 a.m.

General Session Attendance:

Committee members:

Bermudez, Jorge	Unaffiliated Board Member	Unaffiliated Board Member	Present
Crowder, Calvin	American Electric Power Service Corporation	Investor Owned Utility	Present
Dreyfus, Mark	Austin Energy	Municipal	Present
Espinosa, Miguel (Vice Chair)	Unaffiliated Board Member	Unaffiliated Board Member	Present
Fehrenbach, Nick	City of Dallas	Commercial Consumers	Present
Karnei, Clifton (Chair)	Brazos Electric Power Cooperative	Cooperative	Present
Zlotnik, Marcie	StarTex Power	Independent REP	Present

Other Board Members and Segment Alternates:

Walker, Mark	NRG Texas	Independent Generator	Present
Whittle, Brandon	DB Energy Trading	Independent Power Market Representative	Present

ERCOT Staff and Guests:

Anderson, Troy	ERCOT – Manager, Enterprise Project Portfolio
Blackburn, Don	Luminant
Brenton, Jim	ERCOT – Principal Cyber Standard Development
Cleary, Mike	ERCOT – Chief Operating Officer
Clemenhausen, Barbara	Topaz Power Management
Day, Betty	ERCOT – Director, Commercial Operations
DiPastena, Phil	ERCOT – Manager, Enterprise Risk
Doggett, Trip	ERCOT – Chief Executive Officer
Feurerbacher, Paula	ERCOT – Manager, Strategic / Organizational Development
Forfia, David	ERCOT – Director, Informational Technology Infrastructure
Fox, Kip	AEP
Gage, Theresa	ERCOT – Manager, Government Relations
Hellinghausen, Bill	EDR Trading
Helton, Bob	International Power America Services

Jones, Brad	Luminant
Jones, Randy	Calpine
Lester, Suzanne	ERCOT – Executive Assistant, Finance
Oehler, Melissa	Public Utility Commission of Texas (PUCT)
Magness, Bill	ERCOT – Interim Vice President and General Counsel
Manning, Chuck	ERCOT – Vice President and Chief Compliance Officer
Morehead, Juliana	ERCOT – Associate Corporate Counsel
Moseley, Cheryl	EROCT – Manager, ICMP
Morgan, Richard	ERCOT – Vice President and Chief Information Officer
Petterson, Mike	ERCOT – Controller
Seymour, Cesar	Suez Energy
Smitherman, Barry T.	Public Utility Commission of Texas (Chairman)
Stauffer, Tarra	ERCOT – Paralegal
Swanson, Leslie	ERCOT – Manager, Treasury (Contractor)
Wullenjohn, Bill	ERCOT – Director, Internal Audit
Yager, Cheryl	ERCOT – Treasurer

Chairman Karnei announced that a quorum was present.

Approval of Prior Meeting General Session Minutes – June 15, 2010 (Agenda Item 4)

Chairman Karnei asked that the General Session Minutes from the June 15, 2010 (Minutes) be revised to reflect the following:

- Regarding Parent Guarantees for Financial Institutions, the final sentence of the second full paragraph from the bottom of Page 3 of the Minutes should read, “The Committee recommended that the Credit Working Group perform a preliminary review of Morgan Stanley’s proposed changes of the Guarantee.”
- The sentence stating that Mr. Espinosa excused himself from the room during the PCard Update should be removed, and reflected in the Parent Guarantees section as “Mr. Espinosa excused himself from the room during the Morgan Stanley discussion.”

Mr. Karnei asked for a motion to approve the June 15, 2010 General Session F&A Committee meeting minutes as revised.

Miguel Espinosa moved to approve the Minutes as revised. Nick Fehrenbach seconded the motion. The motion passed unanimously with no abstentions.

Review Assumptions for Preparation of the 2011 Annual Operating Budget (Agenda Item 5)

Mike Petterson, ERCOT Controller, provided the Committee with an update on preliminary assumptions for the preparation of the 2011 Annual Operating Budget. Mr. Petterson reminded the Committee of the need to identify and justify future resource requirements prior to making assumptions regarding how the resource requirements would be funded.

Mr. Petterson grouped the resource requirements in to two categories: (1) steady-state base operational resource requirements (i.e., staffing, operating costs, hardware and software, technology maintenance, facilities, construction, financing of past commitments on project expenditures, etc.); and (2) resource requirements related to project initiatives (i.e., Nodal stabilization, replacement of data center hardware and software, and organizational

restructuring consistent with external recommendations). Materials concerning each cost category were provided. Mr. Crowder inquired as to the process for determining the Nodal Stabilization project budget. Mr. Petterson responded that ERCOT had launched a task-based project to review, and identify resources necessary for Nodal Stabilization.

Mr. Espinosa asked whether the 2011 Budget would be based on historical data or on a zero-based bottom-up process. Mr. Petterson replied that although ERCOT would like to work as closely as possible with a zero-based budget, given past system choices, the maintenance of such systems in place in the Zonal market and the incremental systems in place in the Nodal market, it did not seem realistic to do so as far as resource requirements related to project incentives were concerned. However, he noted, from a staffing perspective, the use of a zero-based budget process would be implemented to the extent possible in determining the required resources of an Independent System Operator.

Discussion then turned to the timing for finalizing the recommended 2011 Budget. Mr. Karnei confirmed that there would be opportunities for the Committee to do a preliminary review in August 2010, September 2010, and October 2010, with a final management recommendation to go to the Board of Directors in November 2010 for approval. Committee members encouraged that assumptions be addressed as early in the process as possible.

Quarterly Investment Review (Agenda Item 6)

Leslie Swanson provided the Quarterly Investment Review. She informed the Committee of a slight increase in rates for two funds, but noted that they leveled out by the end of June 2010. Ms. Swanson assured the Committee that ERCOT's strategy remained focused on safety, liquidity, and return, in that particular order, and mentioned that investment funds remained the same as in the prior quarter.

Ms. Swanson noted that ERCOT received \$193,159.29 from the Reserve, bringing ERCOT's total loss down to approximately \$391,000, showing a recovery of about 99.18%.

Messrs. Karnei and Espinosa gave Mr. Bermudez a brief overview and history of ERCOT's funds. Ms. Yager agreed to provide Mr. Bermudez with ERCOT's Investment Standard and meet with him to further discuss ERCOT's financial standards and processes.

Credit Briefing – Potential Credit Risk (Agenda Item 7)

Cheryl Yager provided the Committee with the Credit Briefing on Potential Credit Risk, and reminded the Committee that the base case considers the collateral that ERCOT is allowed to collect, whereas the current case includes, as a minimum, collateral held by ERCOT at the beginning of the simulation period. Ms. Yager directed the Committee to results from a seven-month perspective (representing from May 1, 2010 to November 30, 2010) and a twelve-month perspective, as contained in Committee materials. She noted that base case residual credit risk remained comparable to prior quarters, with slight increases in risk up to the 99% confidence level, and a decrease in risk at the higher percentiles in both the base case and current case scenarios.

Using the base case scenario, Ms. Yager then provided the Committee with a summary of most common outcomes (7-month period) and extreme events (7-month period), and reviewed comparisons of FYE-2009 (7-month), FYE-2009 (12-month), and Q3-2009 (between quarters).

Mr. Karnei provided an overview of ERCOT's history of defaults and subsequent uplifts to the market for new Committee Member, Mr. Bermudez. Ms. Yager added that ERCOT continues to monitor and discuss ERCOT's credit exposure, as well as disclose risks associated therewith. Mr. Bermudez inquired about potential future exposure, the risk profile, and the Credit Risk Model. Ms. Yager offered to include information relating thereto in a briefing with Mr. Bermudez.

Nodal Credit Status (Agenda Item 8)

Cheryl Yager led a discussion on the status of Nodal credit, which included a review of credit monitoring and management systems and processes. She reminded the Committee that credit became part of market trials in May 2010, which included:

- Posting credit reports for counter-parties twice daily;
- Sending available credit limits to Congestion Revenue Rights and Day Ahead Markets;
- Sending collateral calls when credit limits are exceeded;
- Recording "e-collateral" sent by counter-parties via email;
- Identifying and resolving issues as they arose; and
- Executing (and adapting, where needed) operating procedures.

Ms. Yager then discussed credit exposures seen in Nodal market trials and provided an example to highlight the levels of exposures seen in market trials relative to Zonal and Nodal "steady" states. Mr. Karnei asked that updated information be provided at the August 2010 meeting and inquired as to ERCOT's processes for identifying potential risks. Ms. Yager noted that ERCOT credit staff reviewed calculations each day, and watched for new risks that might need to be addressed. Mr. Bermudez inquired as to whether ERCOT was looking at how the Risk Profile would shift with Nodal. Ms. Yager noted that certain key risk factors in the Zonal market were expected to be present in Nodal, and highlighted two (2) new risks that were anticipated in Nodal: (1) the Day Ahead Market; and (2) CRR Obligations. She then summarized how ERCOT was addressing those risks, and highlighted the upcoming implementation of "e" factors in market trials.

Ms. Yager reviewed ERCOT's First Priority Security Interest (FPSI) and noted that Chad Seely, ERCOT Senior Corporate Counsel, would be assisting with issues concerning Nodal protocols. She explained the need for the document and provided an example of how exposure would be treated with, and without, a FPSI. Mr. Bermudez asked if using a FPSI would protect the market under bankruptcy laws. Ms. Yager responded in the affirmative but noted that ERCOT's legal department was investigating the issue.

Ms. Yager informed the Committee that without the FPSI, ERCOT could not be assured that it had the right to certain credits that could be netted from exposure. She then discussed the tentative timeline for drafting ERCOT's FPSI document, and noted that ERCOT received comments from Market Participants and would be circulating a second draft, following legal review, to the Committee at the August 17, 2010 meeting. A final review and possible approval by the Committee and the Board of Directors was expected to be undertaken in September 2010. Mr. Karnei asked that Mr. Seely provide the Committee with an update at the August 2010 meeting. Ms. Yager assured the Committee that Mr. Seely would be available at the August 2010 meeting to discuss the protection of ERCOT's FPSI from a legal standpoint.

Mr. Bermudez requested a further understanding of: (a) ERCOT's processes for defining its current risk profile; (b) ERCOT's risk exposure as Nodal goes live; (c) ERCOT's parameters for

determining whether there would be a shift in ERCOT's risk profile; (d) the size a potential shift and impact thereof to ERCOT's balance sheet; and (e) ERCOT's means of protecting against such shifts. Ms. Yager noted that although data was not indicative of a shift at this point, ERCOT would continue to analyze activity to evaluate risks following Nodal go-live. Mr. Karnei suggested that the Committee continue the discussion and further review ERCOT's risk profile at the August 2010 meeting.

Committee Briefs (Agenda Item 9)

Mr. Crowder commented that the Risk Report would be reviewed in detail at the Board of Directors meeting later that day, and would hold his comments until that time.

No Committee Briefs were provided.

Future Agenda Items (Agenda Item 10)

The following items were identified as future agenda items:

1. Standing Internal Audit agenda items
2. Assessment of compliance, the internal control environment and systems of internal controls
3. Review of preparation of the 2011 Annual Operating Budget
4. Review of assumptions in the 2011 Annual Operating Budget
5. Review Nodal Credit Status
6. Credit Briefing – Potential Future Risk
7. Review filing of IRS Form 990
8. Review of Investment Strategy
9. Quarterly Private Discussion with Chief Audit Executive
10. Committee Briefs
11. Future Agenda Items
12. Board disclosure regarding overpayment of Board reimbursements

Other Business (Agenda Item 11)

None.

Adjournment

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



Juliana Morehead
Associate Corporate Counsel