



Date: September 14, 2010
To: Board of Directors
From: Clifton Karnei, Chair, Finance & Audit (F&A) Committee
Subject: Approval of First Priority Security Interest Agreement

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: September 21, 2010

Agenda Item No.: 9a

Issue:

The F&A Committee of the ERCOT Board of Directors (Board) respectfully requests that the Board approve an ERCOT standard form version of a First Priority Security Interest Agreement for use in accordance with Section 16.11.4.1, *Determination of Total Potential Exposure for a Counter-Party*, of the Nodal Protocols.

Background/History:

Section 16.11.4.1, in part, of the Nodal Protocols indicates the following:

- (1) A Counter-Party's "Total Potential Exposure" (TPE) is: (i) **for a Counter-Party that has granted ERCOT a first priority security interest in receivables generated under or in connection with the Counter-Party Agreement** or is an EC or an Entity created under Texas Water Code (TWC) § 222.001, Creation, **the algebraic sum of its current and future credit exposures**, and (ii) for every other Counter-Party, the sum of its current credit exposure, if positive, and Future Credit Exposures (FCEs), if positive.

Therefore, if a Counter-Party elects to give ERCOT a first priority security interest in any and all accounts receivables generated under and/or in connection with the Counter-Party Agreement, then this Nodal Protocol section allows netting of the "mark to market" or forward values of Congestion Revenue Rights (CRRs) with other current credit exposure of the Counter-Party.

In order to meet this Nodal Protocol requirement, ERCOT Legal developed a standard form version of a First Priority Security Agreement which may be used by Counter-Parties if they choose to give ERCOT a first priority security interest in any and all accounts receivables and therefore receive favorable credit treatment.

ERCOT Legal distributed first and second working draft versions of the First Priority Security Interest Agreement for stakeholder comment in July and August 2010. A majority of stakeholder comments were accepted by ERCOT Legal and incorporated into the final version of the First Priority Security Interest Agreement. ERCOT Legal also discussed the First Priority Security Interest Agreement with the F&A Committee at its meeting on August 17, 2010.

The final version of the First Priority Security Interest Agreement is attached hereto as



Attachment A.

Key Factors Influencing Issue:

ERCOT Legal prefers a standard form version of a First Priority Security Interest Agreement to be used by all Counter-Parties who elect to give ERCOT a first priority security interest in any and all accounts receivables generated under and/or in connection with the Counter-Party Agreement.

Alternatives:

The Board has the following alternatives within its discretion:

1. Accept the F&A Committee's recommendation regarding an ERCOT standard form version of a First Priority Security Agreement.
2. Do not accept the F&A Committee's recommendation of an ERCOT standard form version of a First Priority Security Interest Agreement and allow ERCOT and Counter-Parties to negotiate the terms of a Security Interest Agreement on a case-by-case basis.
3. Instruct ERCOT Legal to revise additional language in the First Priority Security Interest Agreement based upon any additional directives from the Board.

Conclusion/Recommendation:

The F&A Committee is expected to review the First Priority Security Interest Agreement at its meeting on September 21, 2010, and is expected to recommend to the Board whether to approve an ERCOT standard form version of a First Priority Security Interest Agreement for use in accordance with Section 16.11.4.1, *Determination of Total Potential Exposure for a Counter-Party*, of the Nodal Protocols.



ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.
BOARD OF DIRECTORS RESOLUTION

WHEREAS, after due consideration of the alternatives, the Finance and Audit (F&A) Committee of the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) has considered the standard form version of a first priority security interest agreement at its meeting on September 21, 2010, as recommended by ERCOT staff;

WHEREAS, the F&A Committee recommends that the Board approve a standard form version of a first priority security interest agreement for use by Counter-Parties, if elected, in accordance with Section 16.11.4.1, *Determination of Total Potential Exposure for a Counter-Party*, of the Nodal Protocols;

WHEREAS, the Board deems it desirable and in the best interest of ERCOT to accept such F&A Committee recommendation; and

THEREFORE, BE IT RESOLVED, that the Board hereby authorizes and approves ERCOT to confirm approval of the First Priority Security Interest Agreement, which is attached hereto as Attachment A₂ in each and every respect and to accept this First Priority Security Interest Agreement as the standard form version for qualified Counter-Parties to bestow upon ERCOT a first priority security interest in any and all accounts receivables generated under and/or in connection with the Counter-Party Agreement pursuant to Section 16.11.4.1 of the Nodal Protocols.

CORPORATE SECRETARY'S CERTIFICATE

I, Bill Magness, Interim Corporate Secretary of ERCOT, do hereby certify that, at its September 21, 2010 meeting, the ERCOT Board of Directors passed a motion approving the above Resolution by _____.

IN WITNESS WHEREOF, I have hereunto set my hand this ____ day of September, 2010.

Bill Magness
Interim Corporate Secretary

FIRST PRIORITY SECURITY INTEREST AGREEMENT¹

Date: _____

Debtor: [COUNTER-PARTY ENTITY]

Debtor's Mailing Address: _____

Secured Party: ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC. (hereinafter
"ERCOT" or "Secured Party")

Secured Party's Mailing Address: 7620 Metro Center Drive
Austin, Texas 78744

Collateral (including all accessions):

Pursuant to ERCOT Nodal Protocols² Section 16.11.4.1, *Determination of Total Potential Exposure for a Counter-Party*, as the same may be revised, amended, and supplemented from time to time and together with all replacements and substitutes thereto, Debtor hereby grants to ERCOT and its assignees, transferees, successors in interest, a present and continuing first priority security interest in and a first lien (the "First Priority Security Interest") upon all of Debtor's right, title, and interest in any and all accounts receivable generated under and/or in connection with the Counter-Party Agreement³ and all current and future revenues as described and defined in the ERCOT Nodal Protocols together with all of Debtor's right, title, and interest to any accounts, accounts receivable,

¹ Hereinafter called the "Agreement".

² "ERCOT Nodal Protocols" shall mean the document adopted by ERCOT, including any attachments or exhibits referenced in that document, as may be amended from time to time, that contains the scheduling, operating, planning, reliability, and settlement (including customer registration) policies, rules, guidelines, procedures, standards, and criteria of ERCOT. For the purposes of determining responsibilities and rights at a given time, the ERCOT Nodal Protocols, as amended in accordance with the change procedure(s) described in the ERCOT Nodal Protocols, in effect at the time of the performance or non-performance of an action, shall govern with respect to that action.

³ Under the ERCOT Nodal Protocols, the Counter-Party Agreement is also known as the Standard Form Market Participant Agreement, entered into between said Counter-Party (i.e., Debtor) and ERCOT in order to establish the terms and conditions by which ERCOT and Counter-Party will discharge their respective duties and responsibilities under the ERCOT Protocols.

credits, refunds, payments, rebates, revenues, set-off rights, and all other rights to payment of whatever kind or nature arising out of or related to the Counter-Party Agreement whether direct or indirect, absolute or contingent, due or to become due, now existing or hereafter existing, including all products and proceeds of the foregoing, and any and all renewals, extensions, replacements, modifications, additions, and substitutions of the foregoing and all rights, remedies, claims, and demands under and/or in connection with each of the foregoing (the "Collateral").

Obligation Secured (hereinafter the "Obligation" or "Obligations"):

The First Priority Security Interest granted herein by Debtor to Secured Party shall secure the payment and performance of all of Debtor's obligations pursuant to the ERCOT Nodal Protocols and Counter-Party Agreement and the payment and performance of any and all other liabilities and obligations of Debtor to Secured Party of every kind and nature, whether direct or indirect, absolute or contingent, due or to become due, now existing or hereafter existing, including, without limitation, all costs and expenses to enforce the obligations of the Debtor and collect all amounts owed to the Secured Party, including attorney's fees and expenses, arising under this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement.

Other debt/future advances: The First Priority Security Interest granted herein also secures all other present and future debts and liabilities of Debtor to Secured Party, including future advances and including, but not limited to, any and all other debt and any advances made pursuant to this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement.

A. Debtor represents and warrants the following:

1. No financing statement covering the Collateral is filed in any public office other than the financing statement in favor of Secured Party.

2. Debtor owns the Collateral and has the authority to grant this First Priority Security Interest, free from any setoff, claim, restriction, security interest, or encumbrance except liens for taxes not yet due and liens imposed by law in connection with worker's compensation, unemployment insurance and types of social security (in each case, if applicable) (hereinafter "Permitted Liens").

3. The Collateral has not been pledged to any other person or entity and the First Priority Security Interest granted herein is a legal and valid, first priority security interest in the Collateral (subject to Permitted Liens).

4. None of the Collateral is an accession to any goods, is commingled with other goods, or will become an accession or part of a product or mass with other goods except as provided in this Agreement.

5. All information about Debtor's financial condition is or will be accurate in all

material respects when provided to Secured Party.

6. None of the Collateral is affixed to real estate.

7. Debtor is a _____ organized under the laws of the State of _____ and Debtor will notify Secured Party in writing of any change to Debtor's name, state of organization, or entity status, in accordance with Section B.5 below.

8. The Debtor's place of business is _____ and Debtor will notify Secured Party in writing of any change to Debtor's place of business, in accordance with Section B.5 below.

9. The Debtor's execution of this Agreement is a condition precedent to, and made in consideration of, Secured Party granting Debtor credit pursuant to the ERCOT Nodal Protocols.

10. Debtor has received adequate consideration for the execution of this Agreement, the receipt of which is hereby acknowledged by virtue of the execution of this Agreement.

11. The Debtor is authorized to execute this Agreement, and the person signing this Agreement on behalf of Debtor is authorized to do so.

B. Debtor agrees to:

1. Defend the Collateral against all claims adverse to Secured Party's interest; keep the Collateral free from liens, except for liens in favor of Secured Party or Permitted Liens; allow ERCOT to keep all Collateral and any proceeds thereof in ERCOT's possession subject to Debtor's ownership except as otherwise provided in this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement; maintain the Collateral in good condition; and protect the Collateral against waste.

2. Reimburse Secured Party's reasonable expenses incurred in the initial filing related to this Agreement (a copy of which will be provided by Secured Party to Debtor)

3. Pay Secured Party's reasonable expenses incurred in any action to preserve, perfect, defend, and enforce this Agreement or the Collateral and to collect or enforce the Obligations. These expenses will bear interest from the date of advance until paid at the maximum lawful rate for matured, unpaid amounts and are payable on demand at the place where the Obligation is payable. These expenses and interest will become part of the Obligation and will be secured by this Agreement.

4. Take any other action and sign and deliver any other documents that Secured Party, acting in a commercially reasonable manner, considers necessary to obtain, maintain, and perfect this First Priority Security Interest (subject to Permitted Liens).

5. Notify Secured Party promptly of any material change in the Collateral; any change in Debtor's name, address, or location; any change in Debtor's state of organization, any change in any warranty or representation in this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement; any change that may affect this First Priority Security Interest; and any event of default. Written notification regarding the Debtor's change of name, address, location, or jurisdiction shall be provided to Secured Party by Debtor at least thirty (30) days prior to the effective date of such change.

6. Maintain accurate records of the Collateral; furnish Secured Party any reasonably requested information related to the Collateral; and allow Secured Party to inspect and copy all records relating to the Collateral during Debtor's normal business hours.

7. Allow Secured Party to inspect the Collateral.

C. Debtor agrees not to:

1. Commingle, sell, dispose, encumber, or in any way transfer (except as to Permitted Liens) any of the Collateral without the prior written consent of the Secured Party, except in the ordinary course of Debtor's business.

D. Default/Breach and Remedies

1. Debtor shall be in default (or breach) if, after having been given any required notice, the Debtor:

a. fails to comply with or perform any of the Debtor's obligations under this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement;

b. fails to timely pay or perform any obligation or covenant in this Agreement, the ERCOT Nodal Protocols, or the Counter-Party Agreement or any default in payment by Debtor to Secured Party per the Obligation(s) referenced above;

c. makes any false warranty, covenant, or representation to Secured Party in connection with this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement;

d. has a receiver appointed for Debtor or any of the Collateral;

e. assigns the Collateral for the benefit of creditors;

f. to the extent permitted by law, has bankruptcy or insolvency proceedings commenced against or by any of the following parties: Debtor; any partnership of which Debtor is a general partner; or any maker, drawer, acceptor, endorser, guarantor, surety, accommodation

party, or other person liable on or for any part of the Obligation;

g. the dissolution of any of the following parties: Debtor; any partnership of which Debtor is a general partner; or any maker, drawer, acceptor, endorser, guarantor, surety, accomodation party, or other person liable on or for any part of the Obligation; and

h. permits the impairment of any of the Collateral by loss, theft, damage, or destruction, unless it is promptly replaced with collateral of like kind and quality or restored to its former condition.

2. Upon default/breach and at any time thereafter, Secured Party may:

a. demand, collect, convert, redeem, settle, compromise, receipt for, realize on, sue for, setoff, net, and adjust the Collateral either in Secured Party's or Debtor's name, as Secured Party desires, or take control of any proceeds of the Collateral and apply the proceeds against the Obligation;

b. declare the unpaid principal and earned interest of the Obligations immediately due in whole or part;

c. enforce the Obligation; and/or

d. exercise any rights and remedies granted by law, this Agreement or ERCOT Nodal Protocols.

3. Foreclosure of this First Priority Security Interest by suit does not limit Secured Party's remedies under any other applicable law, including the right to sell the Collateral under the terms of this Agreement or the Uniform Commercial Code. Secured Party may exercise all remedies at the same or different times, and no remedy is a defense to any other. Secured Party's rights and remedies include all those granted by law and those specified in this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement.

4. Secured Party's delay, partial exercise, or failure to exercise any of its remedies or rights does not waive Secured Party's rights to subsequently exercise those remedies or rights. Secured Party's waiver of any default does not waive any further default by Debtor. Secured Party's waiver of any right in this Agreement or of any default is binding only if it is in writing. Secured Party may remedy any default without waiving it.

5. If the Collateral is sold after default, recitals in the bill of sale or transfer will be prima facie evidence of their truth, and all prerequisites to the sale specified by this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement and by law will be presumed satisfied.

E. General

1. While the Collateral and any proceeds thereof are in ERCOT's possession, ERCOT shall maintain the Collateral in good condition as provided in this Agreement, the ERCOT Nodal Protocols, and/or the Counter-Party Agreement.

2. Secured Party may at any time:

a. discharge taxes, liens or other encumbrances at any time levied or placed on the Collateral and any payment or expenses incurred by Secured Party for the same shall be immediately reimbursed by Debtor; and

b. file a financing statement or file any other document (including a copy of this Agreement), or take any other action, necessary to obtain, maintain, and/or perfect the First Priority Security Interest.

3. Notice is reasonable if it is mailed in accordance with the Counter-Party Agreement to Debtor at Debtor's Mailing Address at least ten (10) days before any public sale or ten (10) days before the time when the Collateral may be otherwise disposed of without further notice to Debtor.

4. This First Priority Security Interest will neither affect nor be affected by any other security for any of the Obligation. Neither extensions of any of the Obligation nor releases of any of the Collateral will affect the priority or validity of this First Priority Security Interest.

5. This Agreement binds, benefits, and may be enforced by the heirs, executors, administrators, successors in interest, and/or assigns of the parties, except as otherwise provided. Assignment of any part of the Obligation(s) and/or Secured Party's delivery of any part of the Collateral will fully discharge Secured Party from any further responsibility for that part of the Collateral.

6. This Agreement may be amended only by an instrument in writing signed by Secured Party and Debtor.

7. The unenforceability of any provision of this Agreement will not affect the enforceability or validity of any other provision.

8. This Agreement shall be construed according to Texas law. This Agreement is performed in Travis County, Texas. Venue for any disputes related to this Agreement shall be in the state and/or federal courts in Travis County, Texas.

9. Interest on the Obligation secured by this Agreement will not exceed the maximum amount of nonusurious interest that may be contracted for, taken, reserved, charged, or received under Texas law. Any interest in excess of that maximum amount will be credited on the principal of the Obligation or, if that has been paid, refunded. On any acceleration or

required or permitted prepayment, any such excess will be canceled automatically as of the acceleration or prepayment or, if already paid, credited on the principal of the Obligation or, if the principal of the Obligation has been paid, refunded. This provision overrides any conflicting provisions in this and all other instruments concerning the Obligation.

10. In no event may this Agreement secure payment of any debt subject to Title IV of the Texas Finance Code or create a lien otherwise prohibited by law.

11. When the context requires, singular nouns and pronouns include the plural.

12. The term *Obligation* includes all extensions and renewals of the Obligation and all amounts secured by the Obligation.

13. If Debtor and any party executing any document evidencing the Obligation are not the same person, the term *Debtor* includes the party executing the document evidencing the Obligation.

14. Debtor represents that this Agreement is given for commercial purposes.

15. This Agreement is entered into in accordance with, and subject to, the ERCOT Nodal Protocols as may be amended from time to time. To the extent there is a conflict between this Agreement and the ERCOT Nodal Protocols, the ERCOT Nodal Protocols shall control.

16. This Agreement (and each amendment, modification, and waiver in respect of it) may be executed and delivered in counterparts (including by electronic or facsimile transmission) each of which shall be deemed to be an original.

DEBTOR:

[COUNTER-PARTY ENTITY]

By: _____
Its: _____

SECURED PARTY

ERCOT

By: _____
Its: _____

SUBSCRIBED AND SWORN TO before me by the above parties on this ____ day of _____, 20__.

Notary Public, State of Texas