

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

7620 Metro Center Drive (Room 206) – Austin, Texas 78744
September 21, 2010

Pursuant to notice duly given, the Finance & Audit Committee (“F&A” and/or “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 **7:34 a.m.** The Committee immediately went into Executive Session, where it remained until it recessed and reconvened in General Session at **8:20 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	Not 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:

Adib, Parviz	Pioenergy
Anderson, Ken	Public Utility Commission of Texas (PUCT) - Commissioner
Anderson, Troy	ERCOT – Manager, Enterprise Project Portfolio
Beckham, Rebecca	ERCOT – Manager, Financial Reporting
Brandt, Adrienne	Austin Energy
Cleary, Mike	ERCOT – Chief Operating Officer
Clemenhagen, Barbara	Topaz
Delenela, Ann	ERCOT – Director, Critical Infrastructure Security
Denton, Michael	Oliver Wyman
DiPastena, Phil	ERCOT – Enterprise Risk Manager
Doggett, Trip	ERCOT – Chief Executive Officer
Doll, Laura	Unaffiliated Member – ERCOT Board of Directors
Forfia, David	ERCOT – Director, IT Infrastructure
Fox, Kip	AEP

Garcia, Diana	Maxwell Locke & Ritter
Gent, Michehl	Chairman – ERCOT Board of Directors
Hancock, Misti	ERCOT – Manager, Budget & Financial Analysis
Hobbs, Kristi	ERCOT – Manager, Market Rules
Jones, Brad	Luminant
Kolodziej, Eddie	Customized Energy Solutions
Leady, Vickie	ERCT – Senior Corporate Counsel
Lester, Suzanne	ERCOT – Executive Assistant, Finance
Magness, Bill	ERCOT – Interim Vice President and General Counsel
Morehead, Juliana	ERCOT – Associate Corporate Counsel
Moseley, Cheryl	ERCOT – Manager, ICMF
Nikazm, Tamila	Austin Energy
Oehler, Melissa	Public Utility Commission of Texas
Ogelman, Kenan	CPS Energy
Pena, Richard	CPS Energy
Petterson, Mike	ERCOT – Controller
Porter, Lea Anne	ERCOT – Director, Compensation & Benefits
Robinson, Shad	Haley & Olson
Saathoff, Kent	ERCOT – Vice President, Grid Operations and System Planning
Seely, Chad	ERCOT – Senior Corporate Counsel
Stark, Ruth	Public Utility Commission of Texas
Stauffer, Tarra	ERCOT – Paralegal
Stephenson, Randa	Luminant
Swanson, Leslie	ERCOT – Treasury Manager (contractor)
Taylor, William	Calpine
Tietjen, Darryl	Public Utility Commission of Texas
Trayers, Barry	Citigroup Energy
Walker, DeAnn	CenterPoint Energy
Wullenjohn, Bill	ERCOT – Director, Internal Audit
Yager, Cheryl	Treasurer
Zimmerhanel, A.J.	Maxwell Locke & Ritter

Chairman Karnei announced that a quorum was present and that Miguel Espinosa held a proxy for Nick Fehrenbach.

Approval of General Session Minutes – August 17, 2010 (Agenda Item 4)

Mr. Karnei entertained a motion to approve the August 17, 2010 General Session F&A Committee meeting minutes (“Minutes”).

Jorge Bermudez made a motion to approve the Minutes. Marcie Zlotnik seconded the motion. The motion passed unanimously with one (1) abstention by Miguel Espinosa, who was not present at the August 17, 2010 meeting.

Review Results of and Accept the 2009 401(k) Audit Report (Agenda Item 5)

Lea Anne Porter, ERCOT Director of Compensation and Benefits, introduced Diana Garcia and A.J. Zimmerhanel of Maxwell Locke & Ritter and directed the Committee to the 2009 401(k) Audit Report (“Audit Report”) contained in the meeting materials. Ms. Porter and Ms. Garcia

informed the Committee that no significant issues or adjustments were noted in the Audit Report. Ms. Garcia noted that the Audit Report was clean, and Ms. Porter stated that it would be presented for approval at the Board meeting later that day.

Miguel Espinosa made a motion to recommend acceptance of the 2009 401(k) Audit Report to the Board. Calvin Crowder seconded the motion. The motion passed with a unanimous voice vote.

Recommendation of Approval of the First Priority Security Interest Agreement (Agenda Item 6)

Chad Seely reminded the Committee that the First Priority Security Interest Agreement (Agreement) was optional for Market Participants that wished to receive favorable credit treatment under the Nodal Protocols. Mr. Seely noted that the Agreement was the final version containing stakeholder comments, and that although ERCOT could not accept all comments, he believed that it was the best agreement ERCOT could develop based on those comments received.

Mr. Seely stated that he was asking the Committee to recommend that the Board of Directors approve the Agreement as a standard form version for use under the ERCOT Protocols. Mr. Seely confirmed that future edits would not be accepted once the Agreement was approved, but that a process for modifying standard form version agreements was available. Mr. Bermudez inquired as to whether Market Participants would be penalized for not accepting the Agreement. Mr. Seely responded that if a Market Participant could not provide ERCOT with a first priority security interest by way of this Agreement, it would not have the benefit of netting current and future activities under the Nodal Protocols and therefore receiving favorable credit treatment. Mr. Seely indicated that he did not believe this treatment penalized the Market Participant; rather, it would just require the Market Participant to post more security because such activities would not be netted under the Nodal Protocols.

Calvin Crowder made a motion to recommend that the Board of Directors approve the First Priority Security Interest Agreement as presented as a standard form version. Miguel Espinosa seconded the motion. The motion passed with unanimous voice vote.

Review Assumptions for Preliminary Schedules for the 2011 Annual Operating Budget (2011 Budget) (Agenda Item 7)

Mike Petterson noted that cost was ERCOT's primary economic metric and that ERCOT was actively engaged in controlling costs to ensure that it delivered services and fulfilled obligations as efficiently and effectively as possible. Mr. Petterson then recognized Mr. Tietjen and Ms. Stark of the PUCT for their contributions and advice during preparation of the 2011 budget.

Mr. Petterson reported that ERCOT management accepted the responsibility of controlling costs, and added that a significant contributing factor to cost savings was the reduction of staff. He noted a five percent (5%) reduction in staff over the prior twelve (12) months, with further staff reductions expected in 2010-2011 throughout the implementation of Nodal.

Mark Dreyfus asked for an explanation concerning the characterization of reductions. Messrs. Petterson and Doggett noted the 2009 staffing reduction, new career opportunities, and poor performance management as factors affecting reductions. Mr. Petterson confirmed that the proposed staffing reductions were reflected in the budget forecast for the 2011 Budget. Mr.

Crowder noted that savings were captured in the 2011 Budget following staffing realignment, and inquired as to costs to achieve, and whether any such costs had been captured in the 2011 Budget. Mr. Petterson replied that ERCOT had incorporated costs associated with the reengineering and restructuring of the organization in the financial forecast for year-end 2010 as well as the preliminary 2011 Budget.

Mr. Petterson reiterated the assumption that there would be no change to the System Administration Fee (reflected as 41.71 cents per MWh), which would keep the Nodal surcharge at the current level of 37.5 cents per MWh. He added that the flat-fee scenario would require the repurposing of the Nodal surcharge, or identification and recovery of cost in 2011 from the Nodal Surcharge Fee for activity related to Nodal stabilization. Mr. Petterson told the Committee that ERCOT was working on a detailed list of costs and activities related to Nodal stabilization, and would provide it to the Committee in October 2010.

Ms. Zlotnik asked whether the Committee would have an opportunity to review a breakdown of deferred defects. Mr. Cleary responded that his expectation was that the first three to six months following Nodal go-live will be stabilization, and significant work relating to deferred defects, parking deck items, and the like were not expected to commence until the second half of 2011. Mr. Espinosa asked that proposed usage of the \$113 million contingency fund be broken-down to provide the Committee with an overview of its components and associated costs. Mr. Cleary assured the Committee that it would receive this requested information at the October 2010 meeting. Mr. Doggett followed-up by noting that ERCOT would provide the Committee with an explicit list of the work constituting the \$20 to \$30 million of the contingency fund needed to keep ERCOT's fees flat for 2011.

Mr. Dreyfus reminded the Committee that Commission Order in Docket 36851 ("Order"), gives the Board exclusive control over \$58.6 million in the discretionary fund. Thus, he said, the Board was directed by the PUCT to spend money from the Nodal surcharge from the discretionary fund on stabilization. Mr. Dreyfus further noted the importance that the Board use said spending authority to employ its exclusive control in using discretionary funds. Mr. Doggett concurred with Mr. Dreyfus, and noted that Bill Magness indicated that ERCOT should file its acknowledgement to use the discretionary funds in accordance with the Order.

Mr. Crowder inquired about the doubling of North American Electric Reliability Corporation ("NERC") dues. Mr. Petterson noted that the NERC budget was approved by FERC and then allocated by NERC to ERCOT. It was his opinion that the increase in dues resulted from an increase in the NERC and Texas Reliability Entity, Inc. budgets.

Mr. Crowder then asked whether EMMS Development, as set forth on Page 31 of the Committee materials, was an Operations and Maintenance ("O&M") item. Mr. Petterson responded that the line item represented the dedicated onsite resources from firms that were available to provide ERCOT with proprietary software resources during the Nodal transition. Mr. Cleary further enunciated that the item referred to resources that were dedicated to ERCOT, until a particular application's end-of-life, which were available to ERCOT on an on-call basis in the event of a problem with the application. Committee members then held a lengthy discussion concerning Outside Services data, which was redeployed under the line item titled Subscriptions and Dues. Mr. Karnei recommended that this particular budget category be more clearly named.

Messrs. Doggett and Petterson agreed to provide an additional Budget Schedule at the October 2010 Committee meeting to identify the "big bucket" budget items. Mr. Karnei confirmed that

the 2011 Annual Operating Budget was on schedule for final review and discussion at the October 2010 Finance and Audit Special Meeting. It was further noted that the Committee would likely be presented with a request to recommend that the Board approve the 2011 Budget at the November 2010 meeting.

Nodal Credit Risk Profile and Status (Agenda Item 8)

Cheryl Yager provided an overview of the Nodal Credit Risk Profile and status. Ms. Yager noted that there were no open defects with the Credit Monitoring and Management ("CMM") system, and that the system was functioning as expected. She then stated that the current issue was confirming the quality of results from the market trials. To aid in that, she noted that old market trials data was removed from CMM for the 168-hour test to allow Market Participants to see what their collateral calculation would be in a go-live situation. At least some of the Market Participants that took part in the test appeared to be operating per a normal scenario and the exposures calculated for those entities were consistent with expectations, she said. Ms. Yager noted a net increase in collateral requirements due to a) increased activity and b) some high prices in the real-time market. She reiterated that ERCOT would continue to communicate with Market Participants for feedback regarding testing and any concerns they had.

Ms. Yager informed the Committee that the metrics for system readiness, process readiness, and people readiness had been met.

Ms. Yager highlighted some key points from the PJM benchmark report and answered questions. She also noted that Oliver Wyman was working on their review, which was on target for the October F&A meeting. Mr. Crowder asked whether the Oliver Wyman report could be presented to the Committee prior to the day of the October 2010 meeting. Ms. Yager responded that ERCOT expected to forward the report to the Committee with the Board materials for the October 2010 meeting a week prior to the meeting. Chairman Karnei asked Ms. Yager to circulate proposed language that the Committee might use in its recommendation for Board approval concerning credit certification. Ms. Yager assured Chairman Karnei that she would forward the applicable language to the Committee prior to the October 2010 meeting.

Ms. Yager then highlighted a couple of open items being worked on in the market. First, she noted that the CWG / MCWG was currently reviewing two parameters used in the CRR auction to hold collateral for potential ongoing liability (e.g. mark to market liability) and that she expected that the Board would see something on this at their October meeting. Ms. Yager noted that the ongoing liability was being captured in a "multiplier" and an "addor" – mechanisms for holding collateral during an auction. The multiplier was currently set at one and the addor at \$1.50. She stated that the multiplier should be set to zero, rather than one, to prevent doubling up on the collateral requirement, and that the market was discussing reducing the addor from \$1.50. Both changes could easily be made before the Nodal go-live date, she expressed. Mr. Crowder asked whether the addor was per MWh. Ms. Yager responded that she believed it was per CRR, but would provide the Committee with a clarification by the October 2010 meeting.

Ms. Yager then discussed Day-Ahead-Market ("DAM") credit constraints and noted that a significant amount of credit was consumed during market trials on non-business days due to the current configuration in the DAM. Ms. Yager informed the Committee that the Technical Advisory Committee ("TAC") approved a potential change to methodology in the DAM system, and also requested that Available Credit Limits ("ACLs") be updated daily as an alternative or addition. These two recommendations were forwarded for CEO review. She noted that, based on that review, ERCOT would process ACLs daily, including non-business days, at market open

on an interim basis to ensure that credit was handled effectively on non-business days. She noted that a long-term automated solution might be considered after Nodal go-live. Chairman Karnei asked Ms. Yager to clarify credit processing and the ability for a market participant to post credit on a weekend or holiday. Ms. Yager responded that a Market Participant could not send cash on a non-business day. She noted that the DAM system held additional collateral for a level of potential risk over non-business days since the real risk was not updated until the next business day. While higher, this potential risk is predictable, she said. She added that with ACLs updated daily over non-business days, risk estimates will be better; however, overall ACL would likely be less predictable (e.g. if high prices were experienced, etc) over non-business days. She reiterated that, given the current configuration in the DAM for non-business days, ERCOT would process ACLs daily at market Go Live.

Ms. Yager then outlined how e-Factors were handled per Mr. Helton's request at the prior Board meeting. She informed the Committee that e-factors were designed to provide a degree of netting since ERCOT did not have an ability to net within the DAM. She noted that market trials have shown that entities with only load or generation derive limited benefit from the e-factors, whereas those entities that had activity on the bid **and** offer sides derive more benefit. Mr. Karnei requested that Ms. Yager follow-up with Bob Helton regarding e-Factors. Ms. Yager responded that she had, and would further follow-up with Mr. Helton that day.

Ms. Yager discussed the Oliver Wyman study. She reminded the Committee that Oliver Wyman was looking at ERCOT's credit practices, including internal processes and procedures, as well as overall credit policies. She noted that Oliver Wyman would also provide an update to their previous benchmark study. She noted that this update would be more current than the PJM benchmark, but that the scope would be more limited than the PJM study given time constraints. Mr. Crowder inquired as to whether Oliver Wyman was looking into issues such as e-factors. Mr. Denton of Oliver Wyman responded that they planned to look generally at the procedures and impact that e-factors would likely have on the amounts of collateral required for Market Participants, as well as look at the credit requirements for the CRR auction and the DAM. Ms. Yager reminded the Committee that the PJM Market Credit Comparison was published in June 2008 as an informational document containing ERCOT Zonal data. She then noted the Nodal differentials, and informed the Committee that ERCOT appeared consistent with other Independent System Operators ("ISOs"), but inconsistent in some areas with other markets generally. In Nodal, Ms. Yager stated that ERCOT validated all DAM transactions, applying a hard credit limit, whereas it appeared that other markets did not apply a hard limit for all participants (i.e., those markets did not require their participants to stay within particular credit limits). Mr. Karnei inquired about how other markets socialized residual losses and noted that ERCOT assessed residual credit losses to Market Participants. Ms. Yager confirmed that in Nodal, Market Participants would continue to share in the losses; however, the mechanism changes in Nodal, with all Market Participants (not just load) sharing in the losses. Mr. Karnei asked Ms. Yager to provide Andrew Dalton with the information as discussed.

Credit Work Group ("CWG") Status Update (Agenda Item 9)

Tamila Nikazm, Vice Chair of the Credit Working Group, provided an update on ERCOT's credit readiness for Nodal go-live from CWG's perspective. Ms. Nikazm highlighted the primary open issues and concerns as follows:

1. CMM - extreme data being used in credit calculations, causing high collateral requirements. Ms. Nikazm noted that while the data was much better during the 168-hour test, there were still unusual prices during certain periods

2. DAM - use of the 95th percentile in certain credit calculations. Ms. Nikazm noted that this was a high bar, which could result in a significant amount of collateral being consumed if there were one or two days of unusual prices, which could consequently impact credit for 30 days DAM - credit consumption over non-business days in the DAM. Ms. Nikazm noted that ERCOT processing ACLs on non-business days should alleviate this concern.
3. DAM – ability to shadow DAM exposure calculation. Ms. Nikazm noted that ERCOT was working with the market to address this.
4. CRR – high collateral resulting from the current Multiplier and Adder Ms. Nikazm noted that this was being reviewed by the market.

Ms. Nikazm assured the Committee that CWG would: (a) continue to work to resolve the issues presented; (b) review and recommend solutions for any new concerns raised in Nodal trials; and (c) make a formal recommendation to the Committee as to Nodal credit readiness at the October 2010 meeting.

Mr. Karnei asked that CWG review the Oliver Wyman Report and inform the Committee at the October 2010 meeting as to whether CWG agreed and/or disagreed with Oliver Wyman's conclusions.

Annual Review of Committee Charter and Structure (Agenda Item 10)

Vickie Leady, ERCOT Senior Corporate Counsel, discussed proposed changes to the F&A Committee Charter as well as the HR&G Committee Charter. She suggested that language contained in the charters concerning the assembly of members and quorum requirements be synched for conformity. Mr. Karnei agreed that consistency was important, and asked Ms. Leady to speak with Andrew Dalton about the issue and work to coordinate the language of the charters. Chairman Karnei noted that this issue would be readdressed at the October November 2010 meetings.

Quarterly Committee Education on Accounting Developments (Agenda Item 11)

Rebecca Beckham, Manager of Financial Reporting, provided the Committee with the quarterly update on accounting developments, as requested by the Committee and recommended by ERCOT's external auditors (Ernst & Young). Ms. Beckham reviewed both proposed and implemented accounting standards, as well guidance concerning the implications of such standards upon ERCOT.

Ms. Beckham highlighted two proposals that would be in effect in 2011 and directly affect ERCOT; one of which would also affect the Committee.

1. SSAE No. 16 – *Reporting on Controls of a Service Organization*. This proposal would affect the SAS 70 audit that ERCOT receives, stated Ms. Beckham. While maintaining the same standards as in the past, the new SAS 70 standard will require ERCOT management to provide a written assertion as to ERCOT controls and the operating effectiveness thereof.
2. PCAOP Proposed Auditing Standard – *Communications with Audit Committees*. Although not fully released, Ms. Beckham noted that this proposal would try to increase the communications between the Committee and ERCOT's independent auditor. Thus, she said, the independent auditor would evaluate whether management was communicating accounting pronouncements and accounting judgments and estimates.

Mr. Karnei asked Ms. Beckham to address the proposal concerning leases. Ms. Beckham discussed an exposure draft released on August 17, 2010 concerning capital and operating leases. She stated that ERCOT held capital and operating leases, and under the proposal, the direct classification of leases would be eliminated, and every lease would be classified on the balance sheet. The effect would be a change in presentation, rather than a change in ERCOT's overall net assets, she noted.

Ms. Beckham then provided the Committee with a summary of accounting judgments that were applied in the third quarter of 2010, but went into effect in the second quarter. The most notable, she mentioned, was related to the presentation of revenue and expense related to ERCOT's Electric Reliability Organization ("ERO") billing on behalf of NERC and Texas Reliability Entity ("TRE"). The revenue and expense should be presented as gross, rather than net, since TRE is a separate entity, Ms. Beckham said. Overall, no impact would be shown on ERCOT's net income or assets, but a change in the way the revenue and expenses look would be seen, she advised. Mr. Karnei and Ms. Beckham agreed that there were few judgments that would affect ERCOT's financial statements.

Committee Briefs (Agenda Item 12)

Mr. Karnei noted an increase in the number of Market Participants from July to August, and asked whether the increase was based on Nodal. Ms. Yager responded in the affirmative.

Ms. Yager further stated that ERCOT was in the process of opening additional investment accounts in preparation for Nodal go-alive and in anticipation of having additional cash that will be posted.

Future Agenda Items (Agenda Item 13)

Mike Petterson noted the full agenda for October. Chairman Karnei suggested that the October 2010 meeting focus on budget and credit. The Committee agreed to move the review of Ernst & Young to the November 2010 meeting.

The following items were identified as Future Agenda Items:

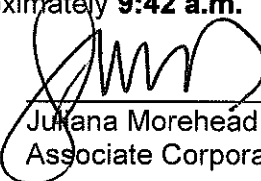
1. Standing Internal Audit agenda items
2. Review assumptions and preliminary schedules for the 2011 annual operating budget
3. Annual review of Committee Charter and structure
4. Standing Nodal Credit Status
5. Review of investment strategy
6. Committee briefs
7. Future Agenda Items

Other Business (Agenda Item 14)

None.

Adjournment

Mr. Karnei adjourned the meeting at approximately **9:42 a.m.**



Juliana Morehead
Associate Corporate Counsel