ERCOT

Date: April 12, 2011
To: Board of Directors
From: Mike Petterson, Vice President of Finance and Treasury
Subject: 2010 Audited Financial Statements

Issue for the ERCOT Board of Directors

ERCOT Board of Directors Meeting Date: April 19, 2011
Agenda Item No.: 18a

Issue:
ERCOT must obtain an annual audit of its financial records pursuant to its Bylaws.

Background/History:
Section 10.6 of the ERCOT Bylaws provides that "[a]t least annually, an audit of the financial statements of ERCOT shall be performed by the Auditor approved by the Board." Ernst & Young LLP (E&Y) was engaged by ERCOT, subsequent to approval by ERCOT's Board of Directors (Board) on November 16, 2010, to perform the annual audit of ERCOT's financial books and records.

On April 18, 2011, it is expected that E&Y will meet with the Finance & Audit Committee (F&A Committee) of the Board to discuss the proposed audit report for year 2010 and E&Y's assessment of the internal controls, recommendations, and other business items raised by the F&A Committee.

The audit opinion is expected to be unqualified or "clean", and the F&A Committee is expected to recommend Board of Director acceptance of the audited financial statements as presented by E&Y during their meeting on April 18, 2011.

Key Factors Influencing Issue:
The key factors influencing the decision are: ERCOT's Bylaws requirement; a debt covenant requirement that audited financial statements are provided to the lenders by April 30, 2011; and the expectation that E&Y will issue an unqualified opinion in connection with their audit of ERCOT's 2010 financial statements.

Alternatives:
If, as expected, the audit opinion is recommended for acceptance by the F&A Committee, the Board has two alternatives:

1. Accept the audited financial statements as presented by E&Y; or
2. Postpone the acceptance of the audited financial statements until a future date following additional investigation or discussion with E&Y or management regarding the financial statements. If this alternative is chosen, ERCOT staff will work with the appropriate lenders to seek a waiver to debt covenants relating to the timing of the availability of audited financial statements.

Conclusion/Recommendation:

If the F&A Committee recommends Board acceptance of the audited financials and Report on Audit of Financial Statements for the Years Ended December 31, 2010 and 2009, then ERCOT Staff respectfully recommends acceptance.

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

WHEREAS, after due consideration of the alternatives, the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) deems it desirable and in the best interest of ERCOT to accept the ERCOT audited financial statements and Ernst & Young LLP Report on Audit of Financial Statements for the Years Ended December 31, 2010 and 2009 (Report);

THEREFORE, BE IT RESOLVED, that ERCOT is hereby authorized and approved to accept the ERCOT audited financial statements and Report.

CORPORATE SECRETARY'S CERTIFICATE

I, Bill Magness, Corporate Secretary of ERCOT, do hereby certify that, at its April 19, 2011 meeting, the ERCOT Board passed a motion approving the above Resolution by _______.

IN WITNESS WHEREOF, I have hereunto set my hand this ___ day of April, 2011.

____
Bill Magness
Corporate Secretary

Financial Statements

Electric Reliability Council of Texas, Inc.
December 31, 2010 and 2009
With Report of Independent Auditors

Electric Reliability Council of Texas, Inc.

Financial Statements

December 31, 2010 and 2009

Contents

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Report of Independent Auditors

We have audited the accompanying statements of financial position of the Electric Reliability Council of Texas, Inc. (ERCOT) as of December 31, 2010 and 2009, and the related statements of activities, and cash flows for the years then ended. These financial statements are the responsibility of ERCOT's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of ERCOT's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ERCOT's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Electric Reliability Council of Texas at December 31, 2010 and 2009, and the results of its activities and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

________, 2011

Electric Reliability Council of Texas, Inc.

Statements of Financial Position

	December 31	
	2010	**2009**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 69,556**	$ 78,815
Accounts receivable	**9,344**	8,809
Unbilled revenue	**9,115**	6,590
Restricted cash	**255,598**	132,331
Prepaid expenses and other current assets	**13,982**	13,040
Total current assets	**357,595**	239,585
Property and equipment, net	**452,996**	114,389
Systems under development	**7,381**	313,007
Debt issuance costs	**467**	651
Total assets	**$ 818,439**	$ 667,632
Liabilities and unrestricted net assets		
Current liabilities:		
Accounts payable	**$ 4,265**	$ 5,722
Accrued liabilities	**19,552**	13,753
Deferred revenue	**3,302**	4,270
Market settlement liabilities	**65,827**	79,204
Security deposits	**255,598**	132,331
Regulatory liabilities, current portion	**–**	78
Notes payable, current portion	**224,470**	168,470
Total current liabilities	**573,014**	403,828
Notes payable	**111,737**	196,208
Derivative liability	**9,832**	12,733
Regulatory liabilities	**87,660**	38,147
Other long term liabilities	**323**	1,726
Total liabilities	**782,566**	652,642
Commitments and contingencies *(Notes 8 and 12)*		
Unrestricted net assets	**35,873**	14,990
Total liabilities and unrestricted net assets	**$ 818,439**	$ 667,632

The accompanying notes are an integral part of these financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Activities and Net Assets (Deficit)

	Year Ended December 31 2010	2009
	(In Thousands)	
Operating revenues:		
System administration fees	**$ 132,951**	$ 128,519
Nodal implementation surcharge	**119,718**	52,113
Reliability organization pass-through	**12,169**	6,940
Membership fees and other	**4,018**	3,552
Total operating revenues	**268,856**	191,124
Operating expenses:		
Salaries and related benefits	**54,450**	56,166
Depreciation	**29,645**	28,791
Facility and equipment costs	**9,123**	8,320
Consulting and legal services	**14,035**	12,559
Administrative and other	**14,462**	7,771
Hardware and software maintenance and licensing	**9,251**	9,752
Amortization of regulatory asset	**119,718**	52,113
Total operating expenses	**250,684**	175,472
Income from operations	**18,172**	15,652
Other income (expense):		
Interest income	**7**	3,502
Interest expense	**(2,733)**	(2,720)
Change in valuation of interest rate swap	**2,901**	2,019
Non-operating income	**3,613**	12,280
Change in unrestricted net assets (deficit) before deferred pension costs and distribution of net assets	**21,960**	30,733
Deferred pension costs	**(43)**	7
Distribution of net assets- Texas RE	**(1,034)**	–
Change in unrestricted net assets (deficit)	**20,883**	30,740
Unrestricted net assets (deficit), beginning of year	**14,990**	(15,750)
Unrestricted net assets, end of year	**$ 35,873**	$ 14,990

The accompanying notes are an integral part of these financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows

	Year Ended December 31	
	2010	**2009**
	(In Thousands)	
Cash flows from operating activities		
Change in unrestricted net assets (deficit)	**$ 20,883**	$ 30,740
Adjustments to reconcile change in unrestricted net assets (deficit) to net cash provided by operating activities:		
Depreciation	**29,645**	28,791
Amortization of debt issuance costs	**184**	244
Change in valuation of interest rate swap	**(2,901)**	(2,019)
Change in valuation of assets due to sales and use tax refund	**–**	8,758
Net (gains) losses on disposition or impairment of capital assets	**(44)**	27
Changes in operating assets and liabilities:		
Accounts receivable	**(535)**	(4,465)
Unbilled revenue	**(2,525)**	3,079
Prepaid expenses and other assets	**(942)**	3,616
Other long-term liabilities	**(1,403)**	1,042
Accounts payable	**(1,172)**	(2,073)
Accrued liabilities	**2,972**	(2,877)
Deferred revenue	**(968)**	2,561
Regulatory liabilities	**91,909**	30,545
Net cash provided by operating activities	**135,103**	97,969
Cash flows from investing activities		
Capital expenditures for property and equipment and systems under development	**(102,527)**	(118,161)
Proceeds from sale of property and equipment	**13**	23
Net cash used in investing activities	**(102,514)**	(118,138)

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows (continued)

	Year Ended December 31 2010	2009
	(In Thousands)	
Cash flows from financing activities		
Proceeds from issuance of notes payable	**$ 56,000**	$ 37,400
Repayment of notes payable	**(84,471)**	(13,637)
(Increase) decrease in restricted cash	**(123,267)**	92,966
Decrease in market settlement liabilities	**(13,377)**	(46,349)
Increase (decrease) in security deposits	**123,267**	(92,966)
Net cash used in financing activities	**(41,848)**	(22,586)
Net decrease in cash and cash equivalents	**(9,259)**	(42,755)
Cash and cash equivalents, beginning of year	**78,815**	121,570
Cash and cash equivalents, end of year	**$ 69,556**	$ 78,815
Supplemental information		
Cash paid for interest	**$ 15,034**	$ 15,331
Supplemental disclosure of non-cash investing and financing activities		
Change in accrued capital expenditures	**$ 2,542**	$ (2,881)
Capitalized interest	**$ 12,206**	$ 13,031

The accompanying notes are an integral part of these financial statements.

1. Organization and Operations

The Electric Reliability Council of Texas, Inc. (ERCOT or the Company) is an independent, not-for-profit corporation. Since July 31, 2001, ERCOT has also functioned as the independent system operator for its reliability region which comprises about 85 percent of the electrical load in Texas. The ERCOT region has approximately 82,700 Megawatts of installed generating capacity, including approximately 73,700 Megawatts of available capacity.

The Public Utility Commission of Texas (PUCT) has primary jurisdictional authority over ERCOT which is responsible for ensuring the adequacy and reliability of electricity across the state's main interconnected power grid and for operating and settling the electricity markets it administers. ERCOT's market rules and operations are carried out in accordance with its Protocols filed with the PUCT. The ERCOT electric service region is contained completely within the borders of Texas, and it has only a few direct current ties across state lines to import or export power with neighboring reliability regions. ERCOT has no synchronous connections (alternating current) across state lines. As a result, ERCOT is considered "intrastate" and does not fall under the jurisdiction of the Federal Energy Regulatory Commission (FERC) except for reliability issues under the provisions of the Federal Energy Policy Act of 2005.

ERCOT is governed by a Board of Directors composed of 16 members. One board member is selected from each of the following market participant groups: retail electric providers, independent generators, independent power marketers, investor-owned utilities, municipal-owned utilities, and electric cooperatives. The remaining ten seats on the Board are filled by three consumer representatives, five unaffiliated Board members, the Chair of the PUCT and ERCOT's Chief Executive Officer.

2. Summary of Significant Accounting Policies

Method of Accounting

The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Unrestricted Net Assets (Deficit)

Unrestricted net assets are those that are not subject to restrictions or stipulations and that may be expendable for any purpose in performing ERCOT's objectives. Accordingly, net assets of ERCOT and changes therein are classified and reported as unrestricted net assets (deficit).

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities of the financial statements and reported amounts of revenues, expenses, and capital expenditures during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to current year classifications.

Cash and Cash Equivalents

Cash and cash equivalents consist of deposits in banks, money market investment accounts, and overnight deposits in government-backed securities with an original maturity date of 90 days or less.

Cash and cash equivalents consists primarily of amounts held by ERCOT on behalf of market participants for congestion management funds and prepayments of settlement obligations (as described in Note 2 – Market Settlement Liabilities).

Restricted Cash

Restricted cash primarily represents amounts received for security deposits from ERCOT's market participants.

Accounts Receivable and Revenue Recognition

ERCOT funds its operations primarily through transaction fees collected from electric service providers operating within the Texas grid. Two volume related fees are charged pursuant to the ERCOT protocols and as approved by both the ERCOT board of directors and the PUCT, each

2. Summary of Significant Accounting Policies (continued)

of which is based on actual volume consumption. Revenues from these fees are recognized in the period that the underlying energy transaction occurs. Amounts not yet billed are accrued and presented as unbilled revenue on the statement of financial position.

System administration fee – This fee was 41.71 cents per megawatt hour of adjusted metered load in both 2010 and 2009 and is structured to provide funding for ERCOT's core operations and related services.

Nodal implementation surcharge – In 2006, ERCOT began collecting an additional rate of 6.63 cents per megawatt hour (real time net metered generation) in connection with the Texas Nodal Market Implementation Project (TNMIP) described in Note 10. Effective June 2007, ERCOT increased the project surcharge to 12.7 cents per megawatt hour, and, effective June 2008, ERCOT increased the project surcharge to 16.9 cents per megawatt hour. Effective January 2010, ERCOT increased the project surcharge to 37.5 cents per megawatt hour. Revenue recognition for this fee is impacted by regulatory requirements established by the PUCT as described in Note 10.

Reliability organization pass-through – In 2008, the system administration fee included 1.69 cents to fund the North American Electric Reliability Corporation (NERC) reliability functions performed primarily by Texas Regional Entity, Inc. (Texas RE), a division of ERCOT through June 30, 2010 (as described further in Note 10). The system administration fees associated with expenses incurred by Texas RE were reported as reliability pass-through revenues. Effective January 2009, ERCOT replaced this portion of the fee with a fixed quarterly Electric Reliability Organization (ERO) billing. The ERO billing is based on actual NERC funding.

ERCOT's other revenue relates to services offered to its participants including connectivity to ERCOT's grid, wide-area network usage, and membership dues. Revenue related to these services is recognized either as the services are performed or at the completion of the project, assuming ERCOT has no significant continuing obligation and collection is reasonably assured. The Company does not maintain an allowance for doubtful accounts as it does not believe it has a material risk of loss associated with lack of collection. Membership dues are recognized over the membership period.

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment consists primarily of computer equipment, software, and buildings for operations and are recorded at cost. Depreciation is computed on the straight-line method using the half year convention over the estimated life of the asset. The cost of betterments to, or replacement of, property and equipment is capitalized. When assets are retired or otherwise disposed of, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in the statement of activities for the period. Included in non-operating income, the Company recognized a gain of $44 and a loss of $27 in 2010 and 2009 respectively. This represents the net book value of property and equipment that was disposed of or no longer in service. Repairs and maintenance costs are expensed when incurred.

ERCOT's depreciable lives (in years) for property and equipment are:

Asset Category	Depreciable Life
Computer Hardware	3
Software	5
Vehicles	5
Furniture and Equipment	7
Mechanical Building Components	10
Buildings	30
Leasehold Improvements	Life of the lease

Systems Under Development

ERCOT continues to develop the information systems and grid operating systems that are being used in its operations. ERCOT capitalizes direct costs and related indirect and interest costs incurred to develop or obtain these software systems, most of which are developed in connection with system development contracts with external firms. Internal costs and contract expenditures not related directly to the development of systems, and related testing activities, are expensed as incurred. Costs from completed projects are transferred to property and equipment when the systems are placed in service.

2. Summary of Significant Accounting Policies (continued)

Impairment

ERCOT evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment exists, it is measured as the difference between the net book value of the asset and its estimated fair value. Impairment is computed by comparing the expected future cash flows, undiscounted and before interest, to the carrying value of the asset. No impairments requiring write-offs were identified in 2010 or 2009.

Interest Capitalization

Interest is capitalized in connection with the construction of major software systems and buildings and improvements. The capitalized interest is recorded as part of the asset to which it relates and is amortized or depreciated over the asset's estimated useful life. During 2010 and 2009, capitalized interest costs were $12,206 and $13,031, respectively.

Market Settlement Liabilities

Market settlement liabilities primarily represent two types of funds held on behalf of the ERCOT market: congestion management funds and prepayments of settlement obligations. Market participant settlement amounts are collected and redistributed by ERCOT in the normal course of managing the settlement of ERCOT's markets. Such settlement obligations are generally held for less than fifteen days before distribution to the market in accordance with timetables set forth in ERCOT's Protocols.

Effective November 1, 2010, ERCOT manages a congestion revenue rights (CRR) program which includes monthly auctions and may include auctions for longer than one month in 2011. Prior to this date, ERCOT managed a transmission congestion rights (TCR) program which included annual and monthly auctions. The change in congestion management programs occurred in connection with the implementation of the Nodal market as discussed further in Note 10. Under both programs, ERCOT collects and holds the proceeds from the auctions until the proceeds are distributed according to provisions of the ERCOT Protocols. ERCOT's Financial Corporate Standard, adopted by the Board of Directors, includes a provision that funds held as a result of CRR or TCR auctions may be used to fund ERCOT working capital and capital expenditure needs within certain guidelines.

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Market settlement liabilities consist of the following at December 31:

	2010	2009
CRR/TCR auction funds	**$ 29,861**	$ 67,122
Prepayments of settlement obligations	**35,966**	12,082
Total market settlement liabilities	**$ 65,827**	$ 79,204

Security Deposits

Market participants not meeting certain creditworthiness standards referenced in ERCOT Protocols may maintain a cash security deposit with ERCOT in order to mitigate credit risk in lieu of providing alternative means of security such as corporate guaranties, letters of credit, or surety bonds. Cash security deposits are classified as restricted cash.

Income Taxes

ERCOT is exempt from Federal income tax under Section 501(c)(4) of the U.S. Internal Revenue Code.

Debt Issuance Costs

ERCOT capitalizes issuance costs related to debt. The amounts are classified in non–current assets and amortized over the life of the debt.

Financial Instruments

The carrying values reported on the balance sheet for current assets and liabilities and for the revolving lines of credit and term loan approximate their fair values. The fair value of the Company’s senior notes payable is $59,465 and $71,618 as of December 31, 2010 and 2009. The fair value is estimated based on net present value calculations and quoted market prices for similar issues.

2. Summary of Significant Accounting Policies (continued)

ERCOT uses interest rate swap agreements, which are derivative instruments, to reduce interest rate risk. ERCOT presents these interest rate swaps at fair value in the statement of financial position and recognizes changes in fair value in the statement of activities and net assets (deficit).

Accounting for the Effects of Regulation

ERCOT is subject to the provisions of the Financial Accounting Standards Board in accounting for the effects of rate regulation. These provisions require regulated entities, in appropriate circumstances, to establish regulatory assets and/or liabilities, and thereby defer the income statement impact of certain revenues and charges because it is probable they will be recovered or repaid in future periods.

Investment Gains/Losses

Based on market events in 2008 related to The Reserve's Primary Fund, ERCOT recorded a valuation reserve of $3,961 on its money market investments as of December 31, 2008. These unrealized losses were included in non-operating expense and represented the decrease in fair market value of ERCOT's investments in the Primary Fund. In addition, The Reserve imposed redemption restrictions on all investments in the Primary Fund and established a plan for the liquidation and distribution of fund assets.

As of December 31, 2010, ERCOT has received total distributions of $47,451 of its original investment of $47,842. Based on these distributions received from The Reserve, ERCOT recognized a gain of $3,410 in 2010 and $160 in 2009. The gain is included in non-operating income in the statement of activities and net assets (deficit) and is a component of the unrestricted net assets at December 31, 2010 and 2009.

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements

Effective for financial statements issued after December 15, 2009, ERCOT adopted Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 expands disclosure requirements related to fair value measurements including (i) separately disclosing the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describing the reasons for the transfers and (ii) presenting separate information for Level 3 activity pertaining to gross purchases, sales, issuances, and settlements. The additional disclosure of Level 3 activity is not effective until fiscal year periods beginning after December 15, 2010. The adoption of ASU No. 2010-06 did not have a material impact on the Company's financial statements.

3. Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are based on inputs of observable and unobservable market data that a market participant would use in pricing the asset or liability. The use of observable inputs is maximized where available and the use of unobservable inputs is minimized for fair value measurement. In a three-tier fair value hierarchy, that prioritizes inputs to valuation techniques used for fair value measurement, the following levels were established for each input:

- Level 1 valuations use quoted prices in active markets for identical assets or liabilities that are accessible at the measurement date. An active market is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

- Level 2 valuations use inputs, other than those included in Level 1, that are observable for the asset or liability, either directly or indirectly.

(Dollars in Thousands)

3. Fair Value Measurement (continued)

- Level 3 valuations use unobservable inputs for the asset or liability. Unobservable inputs are used to the extent observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The input may reflect the assumptions of the reporting entity of what a market participant would use in pricing an asset or liability.

In the case of multiple inputs being used in a fair value measurement, the lowest level input that is significant to the fair value measurement represents the level in the fair value hierarchy in which the fair value measurement is reported.

The following tables set forth by level within the fair value hierarchy ERCOT's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2010 and 2009.

As of December 31, 2010	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents (a)	**$ 69,556**	**$ 69,556**	**$ –**	**$ –**
Restricted cash (a)	**255,598**	**255,598**	**–**	**–**
Total assets	**$ 325,154**	**$ 325,154**	**$ –**	**$ –**
Liabilities				
Interest rate derivatives (b)	**$ 9,832**	**$ –**	**$ 9,832**	**$ –**
Total liabilities	**$ 9,832**	**$ –**	**$ 9,832**	**$ –**

As of December 31, 2009	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents (a)	$ 78,815	$ 78,815	$ –	$ –
Restricted cash (a)	132,331	132,331	–	–
Total assets	$ 211,146	$ 211,146	$ –	$ –
Liabilities				
Interest rate derivatives (b)	$ 12,733	$ –	$ 12,733	$ –
Total liabilities	$ 12,733	$ –	$ 12,733	$ –

(Dollars in Thousands)

3. Fair Value Measurement (continued)

(a) Amounts consist of deposits in banks and money market investments with an average maturity of 90 days or less. The Company calculates fair value using the market approach.

(b) Amounts consist of interest rate swaps with pricing information generated from observable market data and adjusted for credit–risk.

4. Property and Equipment

Property and equipment consists of the following at December 31:

	2010	2009
Computer hardware and equipment	**$ 87,044**	$ 79,036
Software	**588,308**	224,176
Building and leasehold improvements	**92,041**	61,485
Furniture and fixtures	**30,610**	17,268
Land	**947**	246
Vehicles	**124**	124
Construction in progress	**–**	14,864
	799,074	397,199
Accumulated depreciation	**(346,078)**	(282,810)
	452,996	114,389
Systems under development	**7,381**	313,007
Total property and equipment, net	**$ 460,377**	$ 427,396

Systems under development in 2009 consist primarily of costs incurred for the Nodal market transformation project described in Note 10. In connection with the implementation of the Nodal market in 2010, these assets were placed in service in the current year and are included in software above. Systems under development in 2010 consist primarily of costs incurred for ongoing upgrades and improvements to the ERCOT systems.

(Dollars in Thousands)

5. Notes Payable

ERCOT's notes payable consist of the following:

	2010	2009
Revolving lines of credit	**$ 140,000**	$ 84,000
Term loan	**141,666**	212,500
Senior notes	**54,541**	68,178
	$ 336,207	$ 364,678

Revolving Lines of Credit

ERCOT has two revolving lines of credit with JPMorgan Chase Bank, as lead agent, and a separate line of credit under a loan agreement with Bank of America, NA. These facilities are primarily used for short term working capital needs, and individual borrowings under these facilities are structured to mature within one year. The first revolving line of credit with JPMorgan Chase Bank has a maximum amount of available credit of $75,000 and expires on June 15, 2012. As of December 31, 2010, the total debt outstanding under this line of credit is $75,000. The second revolving line of credit with JPMorgan Chase Bank has a maximum amount of available credit of $100,000 and expires on August 13, 2013. As of December 31, 2010, the total debt outstanding under this line of credit is $65,000. The revolving line of credit with Bank of America, NA has a maximum amount of available credit of $50,000 and expires on August 24, 2012. As of December 31, 2010, there are no outstanding borrowings under this line of credit.

The interest rates on these facilities are based on prime rate, a Eurodollar based rate, or other rate as described in the debt agreements. The effective rate of interest at December 31, 2010 was 1.86 percent for the revolving lines of credit, including amounts fixed by interest rate swaps. Additionally, at December 31, 2010, ERCOT pays a commitment fee of 0.10 percent on the unused portion of the $75,000 revolving credit facility and 0.15 percent on the unused portion of the $100,000 and $50,000 revolving credit facilities. During 2010 and 2009, ERCOT incurred commitment fees totaling $268 and $248, respectively, in connection with its debt facilities. The revolving lines of credit have several debt covenants, the most restrictive of which limits ERCOT's indebtedness. At December 31, 2010, ERCOT was in compliance with its debt covenants for these facilities.

(Dollars in Thousands)

5. Notes Payable (continued)

Term Loan

ERCOT also has a term loan with JPMorgan Chase Bank, as lead agent. The term loan has a maximum amount of available credit of $141,666 and expires on December 15, 2012. At December 31, 2010, the term loan is fully drawn with outstanding borrowings of $141,666. As such, there is no commitment fee due on the facility. The interest rates on the term loan are based on prime rate, a Eurodollar based rate, or other rate as described in the debt agreement. The effective rate of interest at December 31, 2010 was 4.95 percent, including amounts fixed by interest rate swaps. The term loan has several covenants, the most restrictive of which limits ERCOT's indebtedness. At December 31, 2010, ERCOT was in compliance with its debt covenants for the term loan.

Senior Notes

ERCOT has $54,541 outstanding in senior notes at December 31, 2010. These senior notes bear interest at 6.17 percent and are due in equal annual principal payments through May 2014. The senior notes have several covenants, the most restrictive of which limits ERCOT's indebtedness and requires the maintenance of an interest reserve equal to the amount of the next installment of interest. The reserve is currently satisfied by available capacity under revolving lines of credit. At December 31, 2010, ERCOT was in compliance with its covenants for the senior notes.

Future maturities of the senior notes and term loan are as follows:

	Senior Notes	Term Loan	Total
Year Ending December 31:			
2011	$ 13,637	$ 70,833	$ 84,470
2012	13,637	70,833	84,470
2013	13,637	–	13,637
2014	13,630	–	13,630
	$ 54,541	$ 141,666	$ 196,207

(Dollars in Thousands)

6. Derivatives

Interest Rate Derivatives

The Company has variable to fixed rate swap agreements (Swaps) with two financial institutions. The notional amounts of the Swaps are primarily related to the term loan, with two Swaps related to a portion of the $75,000 revolving line of credit with JPMorgan Chase Bank. The Swaps generally mature prior to or concurrent with the respective borrowings' due dates. Under the terms of the Swaps, the Company pays the counterparties a fixed rate. In return, the counterparties pay the Company variable interest at LIBOR, which approximates, but does not precisely equal, the rate of interest on the related borrowing. The fixed rate terms of the Swaps and their notional values at December 31, 2010 are summarized in the following table.

Transaction Date	From	To	Fixed Rate Due to Counterparty	Notional Values at December 31, 2010
2007	Nov–07	Nov–11	5.5490%	50,000
2007	Nov–08	Nov–12	5.6550%	30,000
2008	Nov–08	Nov–12	3.2130%	40,000
2009	Nov–09	Jun–12	2.4225%	40,000
2009	Nov–09	Jun–12	2.5225%	40,000

The Company is exposed to the risk of nonperformance if the counterparties default or if the swap agreements are terminated.

(Dollars in Thousands)

6. Derivatives (continued)

Derivative Financial Statement Presentation and Fair Values

At December 31, 2010 and 2009, the fair value of interest rate derivatives was reflected in the statements of financial position as follows:

	Liability Derivatives		
	Statements of Financial Position Location	**2010**	**2009**
Derivatives not designated as hedging instruments			
Interest rate derivatives	Derivative liabilities	**$ 9,832**	$ 12,733
Total		**$ 9,832**	$ 12,733

For the years ended December 31, 2010 and 2009, the unrealized derivative gains arising from interest rate derivatives were as follows:

	Location of Gain recognized in Income	**2010**	**2009**
Derivatives not designated as hedging instruments			
Interest rate derivatives	Change in valuation of interest rate swap	**$ 2,901**	$ 2,019
Total		**$ 2,901**	$ 2,019

7. Employee Benefit Plans

Defined Contribution Plan

ERCOT sponsors the ERCOT Defined Contribution 401(k) Plan (the 401(k) Plan) which is subject to the provisions of the Employee Retirement Income Security Act of 1974. The 401(k) Plan utilizes a third-party administrator. Employees participating in the 401(k) Plan are fully vested after five years. Employees must be 21 years of age to be eligible to participate.

(Dollars in Thousands)

7. Employee Benefit Plans (continued)

ERCOT matches 75 percent of the employee's contribution up to 6 percent of eligible compensation as defined in the 401(k) Plan document. Employees are fully vested for the ERCOT match of 75 percent after five years. In addition, ERCOT contributes 10 percent of a participant's eligible compensation as defined in the 401(k) Plan document. Employees are fully vested for the ERCOT contributions of 10 percent after three years. Employer contributions to the 401(k) are summarized in the table below:

	2010	2009
75 percent of the employee's contribution up to 6 percent	**$ 1,851**	$ 2,050
10 percent of the employee's compensation	**6,373**	6,511
Total employer contributions	**$ 8,224**	$ 8,561

Defined Benefit Plan

During 2009 and 2010, ERCOT offered post-retirement health benefits to employees hired in 1997 or earlier and who retire between age 55 and 65 with 10 years or more of service. This plan allows retirees to participate in the medical and prescription drug coverage available to employees, subject to certain annual and lifetime benefit limits.

Related to this plan, in 2010 ERCOT recognized an increase in the post-retirement liability of $85, operating expenses of $42 and an increase to deferred pension costs of $43. In 2009, ERCOT recognized an increase in the post-retirement liability of $28, operating expenses of $35 and a decrease to deferred pension costs of $37.

(Dollars in Thousands)

8. Lease and Contract Commitments

The Company has noncancellable operating leases and service contracts providing telecommunication services, system infrastructure and office facilities. Most notably, ERCOT leases approximately 45,000 square feet of office space in Austin, Texas. The initial facility lease began in the second quarter of 2001 and covered a 120 month period, with two optional renewal periods available. Effective in early 2011, ERCOT exercised a 36 month renewal to extend the facility lease to March 2014. Minimum payments due under these commitments are:

2011	$ 666
2012	675
2013	685
2014	193
2015	32
Thereafter	8
Total minimum lease payments	$ 2,259

ERCOT recognized $1,003 and $936 of office rent expense in 2010 and 2009, respectively.

9. Concentrations

ERCOT provides reliability and market services to market participants. ERCOT settles the costs of these services by passing through the costs of such services from the providers to the users of such services. In the event that a market participant is unable to make payment on its market obligations, ERCOT's Protocols stipulate that the amount of the default is to be allocated to other market participants based on their market activity and define the allocation mechanism. In order to limit the risks associated with such occurrences, ERCOT requires a cash security deposit, letter of credit, corporate guaranty, or surety bond from market participants that do not meet certain credit standards. Credit risk related to trade receivables associated with ERCOT's fees are substantially mitigated by the fact that, by Protocol, ERCOT's fees are paid from market receipts as a first priority before any market obligations are paid.

ERCOT's fee revenue is driven by the demand for electricity rather than the number of market participants. In the event that any market participant representing load ceased to operate, another market participant representing load would assume the role in response to the demand for electricity. As such, ERCOT believes its exposure to a material reduction in revenues associated with the loss of any market participant is limited.

(Dollars in Thousands)

10. Accounting for the Effects of Regulation

Texas Nodal Market Implementation Project (TNMIP)

During 2006, ERCOT began incurring significant costs associated with the TNMIP. This project represents a market redesign and systems upgrade to improve grid reliability, increase market efficiency, and enable transparency of wholesale energy prices.

On December 1, 2010 ERCOT launched the Nodal market, which features locational marginal pricing for generation at more than 8,000 nodes, a day-ahead energy and ancillary services co-optimized market, day-ahead and hourly reliability-unit commitment, and congestion revenue rights. Based on this implementation date, TNMIP software assets previously classified as systems under development on the statement of financial position reclassified to fixed assets with an in-service date of December 1, 2010. These software assets totaled $353,534 with related 2010 depreciation expense of $35,353.

The PUCT set forth the framework of the TNMIP rates, which provides for explicit recovery of all allowable development costs and all debt service costs over the financing period of the project. Some of the development costs encompassed in the rate order would otherwise be treated as period costs under generally accepted accounting principles. Amounts earned under the rate order are presented as Nodal surcharge fees in the accompanying statement of activities and net assets (deficit). TNMIP development costs related to the systems under development are capitalized as discussed in Note 2. All other TNMIP development costs are subject to the provisions of regulatory accounting, which provides for deferral of the income statement impact.

The following is a reconciliation of TNMIP's long term regulatory liabilities at December 31:

	2010	2009
Nodal surcharge fees	**$ 119,718**	$ 52,113
Nodal costs not included in systems under development	**68,547**	30,753
Over collections	**(51,171)**	(21,360)
Regulatory liabilities, beginning of year	**(36,489)**	(15,129)
Regulatory liabilities, end of year	**$ (87,660)**	$ (36,489)

(Dollars in Thousands)

10. Accounting for the Effects of Regulation (continued)

The following is a summary of TNMIP development costs incurred:

	2010	2009
Salaries and related benefits	**$ 9,903**	$ 6,968
Depreciation	**42,312**	10,618
Facility and equipment costs	**901**	880
Consulting and legal services	**8,602**	7,207
Administrative and other	**405**	145
Hardware and software maintenance and licensing	**5,573**	3,757
Interest expense	**851**	1,178
Total TNMIP development costs	**$ 68,547**	$ 30,753

Texas Regional Entity

By order of the FERC, NERC has been designated as the ERO. During 2007, Texas RE, an independent division of ERCOT through June 30, 2010, was approved by FERC to contract with and perform certain activities for NERC. NERC has delegated authority to Texas RE to propose, monitor, and enforce federal electric reliability standards within the designated geographic area within Texas known as the ERCOT region.

On January 1, 2010, a new nonprofit Texas corporation called Texas Reliability Entity, Inc. (New Texas RE) was formed to assume the business, rights, and obligations of Texas RE. On February 19, 2010, NERC filed a petition with FERC requesting: (1) approval of an Amended and Restated Delegation Agreement between NERC and the New Texas RE to develop, and to monitor and enforce compliance with, reliability standards in the ERCOT Region; (2) termination of the existing Amended and Restated Delegation Agreement between NERC and Texas RE; and (3) approval of an Amended 2010 Business Plan and Budget for the New Texas RE. This petition was accepted and approved by FERC on May 6, 2010.

In connection with this approved order, Texas RE divested from ERCOT as of July 1, 2010. The New Texas RE assumed the activities and responsibilities of Texas RE as well as its assets and liabilities, and as of July 1, 2010 ERCOT transferred all assets and liabilities of Texas RE to the New Texas RE. The impact of the divestiture is recognized in 2010 on the statement of activities and net assets (deficit) as a distribution of net assets for $1,034.

(Dollars in Thousands)

10. Accounting for the Effects of Regulation (continued)

Regulatory orders issued by FERC, approving the consolidated annual operating budget prepared and submitted by NERC, include a requirement that NERC and entities to whom NERC has delegated some of its responsibility as the ERO are not entitled to keep financial variances realized as a result of their activity. If revenues exceed expenses incurred in a given year (favorable financial variance), the excess revenue realized in the year must be returned to rate payers in future years. Similarly, if revenues recorded are less than expenses incurred in a given year (unfavorable financial variance), the revenue shortfall realized in the year must be recovered from rate payers in the future years. Therefore, Texas RE revenues and expenses are subject to the provisions of regulatory accounting, which provides for deferral of the income statement impact.

The following is a reconciliation of Texas RE regulatory liabilities at December 31:

	2010	**2009**
Texas RE collections	**$ 3,510**	$ 3,620
Texas RE interest income	**–**	3
Less: Texas RE costs	**3,991**	4,982
Under collections	**481**	1,359
Regulatory liabilities, beginning of year	**(1,736)**	(3,095)
Texas RE divestiture	**1,255**	–
Regulatory liabilities, end of year	**$ –**	$ (1,736)
Current portion	**$ –**	$ (78)
Long term portion	**$ –**	$ (1,658)

11. Sales and Use Tax Refund

In 2008, ERCOT filed a request with the Texas Comptroller of Public Accounts' office (Comptroller) seeking refund of all Texas State sales and use tax paid from January 1, 2001 through April 30, 2008. In April 2008, the Internal Revenue Service recognized ERCOT as a 501 (c)(4) organization as described in the Internal Revenue Code, retroactive to January 1, 2001. As a tax-exempt organization under 501 (c)(4), ERCOT is exempt from federal income tax and Texas State sales and use tax. Prior to this recognition in 2008, ERCOT was deemed a 501 (c)(6) organization and was exempt from federal income tax but subject to Texas State sales and use tax.

Acceptance and approval of ERCOT's refund request occurred during January 2009, and ERCOT received refund checks from the Comptroller in February and April 2009. ERCOT received $12,251 for the period January 1, 2001 through December 31, 2004 and $14,421 for the period January 1, 2005 through April 30, 2008. In total, ERCOT received $26,672 from the Comptroller in 2009, with $3,453 of this refund related to interest.

In 2009, ERCOT recognized $3,453 as interest income and recognized the remaining $23,219 of the refund as follows: $11,432 as non-operating income and $3,029 payment to the City of Taylor as non-operating expense on the statement of activities and net assets (deficit); $4,306 reduction in TNMIP operating expenditures, which were deferred to the statement of financial position as discussed in Note 10; and $4,452 in asset basis adjustments on the statement of financial position.

12. Contingencies

The Company is party to regulatory and legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject. Such proceedings are not anticipated to have a material impact on ERCOT's financial condition, results of operations or cash flow.

13. Subsequent Events

ERCOT has evaluated material subsequent events through April XX, 2011, the date the Company's financial statements were available to be issued.