

MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Met Center

8:00 A.M.

June 20, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at approximately 8:02 A.M. on **June 20, 2006**. The Meeting was called to order by **Darrell Hayslip** who ascertained that a quorum was present.

Meeting Attendance

Committee members:

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Not Present
Darrell Hayslip, <i>Vice Chair, Acting Chair</i>	Calpine Corporation	Ind. Generator	Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
Miguel Espinosa	Independent Board Member	Independent Board Member	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
John Houston for Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present

ERCOT staff and guests present:

Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Delenela, Ann	ERCOT
Doolin, Estrellita	ERCOT
Jones, Sam	ERCOT (CEO)
Kolodziej, Eddie	Customized Energy Solutions
Lanford, Lane	PUC (Executive Director)
McElfresh, Brandon	ERCOT
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Mueller, Paula	PUC (Deputy Executive Director)
Petterson, Mike	ERCOT
Roark, Dottie	ERCOT
Taylor, William	Calpine
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Wullenjohn, William	ERCOT (via telephone)
Yager, Cheryl	ERCOT

Approval of Previous Minutes

Miguel Espinosa moved to approve the minutes for the previous meeting held on May 16, 2006; **Scott Gahn** seconded the motion. The motion passed unanimously.

Review 2005 Financial Audit Recommendations

Mike Petterson provided an overview of the PricewaterhouseCoopers (PwC) report that was distributed to the Committee on May 16, 2006 and was included with the Board meeting materials for June 20, 2006. Mr. Petterson noted that the report identified one significant deficiency regarding year-end accruals and cut-off; however, the identified issues had no significant net effect on the 2005 financial statements. Mr. Petterson explained that the report also noted three other less significant deficiencies: preparation, review, and approval of journal entries (for which ERCOT had already made adjustments); accounting for the interest rate swap; and preparation, review, and retention of period end account reconciliations. Mr. Petterson confirmed to the Committee that, as described in the report, all deficiencies were cleared before the June 30, 2006 month-end close.

Miguel Espinosa asked if staff was comfortable that all issues had been resolved. Mr. Petterson confirmed that, although there was always room for improvement in any organization, all issues had been resolved.

Mr. Petterson notified the Committee that staff would, in the near future, like to present material and seek guidance from the Committee members on the threshold of "materiality" relative to ERCOT's financial statements and decisions made by users of the financial information, and the threshold for transactions deemed "consequential" or "material." Mr. Petterson noted that identifying the agreed upon levels would be helpful to staff as well as PwC auditors in future audits.

Procedures for Handling the Reporting of Violations

Cathy Vance informed the Committee that during the annual mandatory antitrust training of ERCOT employees in the spring by the Legal Department, she had conducted fraud prevention training. Ms. Vance explained that this training had included a discussion of the mechanisms for the reporting of complaints to ensure that employees were aware of their many options. Ms. Vance also notified the Committee that ERCOT was preparing for its annual ethics reaffirmation process for employees. She explained that ethics training would be completed in this process through PowerPoint presentation materials sent to each employee. After reviewing the training materials, employees will be required to execute a reaffirmation of their Ethics Agreement within three to five days.

Review External Auditor Service Pre-approval Status

Mike Petterson reminded the Committee that the Committee Charter requires the Committee to pre-approve all non-audit services provided by ERCOT's independent auditor (PwC), with exception for nominal items which may be approved after the fact. Mr. Petterson notified the Committee that PwC provides only one non-audit service to ERCOT, which is a subscription (<\$5,000) to an accounting research and reference database application, which was pre-approved by the Committee in November 2005.

Review and approve ERCOT annual report

Dottie Roark reviewed the ERCOT annual report with the Committee, answered questions and requested approval of the annual report.

Miguel Espinosa moved to approve for release the annual report; Bob Manning seconded the motion. The motion passed.

Committee Briefs

Risk Stop Light Report Update

Don Meek reviewed the changes on the Risk Management Event Profile Matrix ("Stop Light Report") with the Committee. Mr. Meek noted that there had been a reduction in risk in Counterparty Credit due to adopted PRRs and Communications due to internal activities, including the finalization of documentation of a Crisis Communication Plan. Mr. Meek also stated that ERCOT has 'stabilized' risk measures after April EECF event. Mr. Meek noted that there was an increase in Internal Control Compliance Risk due to staff turnover and lack of training, and that Human Resources and Nodal Implementation still required 'special attention' due to excessive risk levels.

Credit Update

Cheryl Yager provided a brief overview of the credit update materials provided to the members, including the average weekly pricing. Ms. Yager explained the benefit of the timeline-shortening PRRs that had recently passed by estimating the savings to the market in 2005 if the new PRRs had already been in place. Ms. Yager confirmed that the Credit Work Group continues to work on long term credit solutions.

Plan for PUCT involvement in 2007 Budget Preparation

Darrell Hayslip explained that Lane Lanford, Executive Director of the Public Utility Commission ("PUC"), and Paula Mueller, Deputy Executive Director of the PUC, had come to discuss PUC involvement in the 2007 Budget preparation with the Committee. Mr. Lanford and Ms. Mueller explained that, because of the nature of the fee case (contested case requiring notice and opportunity for parties to object); it could not be conducted with the collaborative process requested by the Committee. Ms. Mueller explained that the staff must follow certain processes in preparing the case and the Commissioners must make their fee decision based upon the evidence in the fee case record. Mr. Lanford and Ms. Mueller confirmed that the ERCOT fee process is different from the rate process used for regulated utilities and may need to be conducted more like the PUC budget process.

Mr. Lanford suggested that it might be possible to conduct the fee case process in pieces, with early hearings on certain of the important or controversial concepts, such as debt financing and projects. Darrell Hayslip noted that the Committee was looking for alignment of philosophy with the PUC, so that ERCOT could work on the items that were of importance to the PUC. Mr. Lanford suggested that the process might be broken into several phases, with open hearings during each phase. Mr. Lanford proposed that the categories of the budget could be discussed in the first phase of the process and the amount proposed by ERCOT for each budget category could be determined in the second phase of the process. ERCOT would then get to hear from the Commissioners regarding any "hot button" topics before it finalized the proposed budget, and both parties would better understand which issues would likely be controversial.

Ms. Mueller suggested that the ERCOT budget development process and fee approval process would always be separate—even if inefficient—and cited the following items as likely to be of

interest to the commissioners: 1) compensation levels, 2) use of contract labor, 3) debt financing, 4) projects, and 5) other.

Mr. Espinosa stated that ERCOT would like a smoother process and would like to know, early in the process, what additional information was sought by the PUC. Mr. Espinosa cited an example of the compensation study which had been criticized by Commissioner Smitherman, because it did not include information from other ISOs. However, the reason the study didn't contain ISO data was because of a requirement by PUC staff or a different Commissioner. Mr. Lanford stated that it was never a good idea for ERCOT to act upon the direction of one Commissioner, since it took at least two Commissioners to approve a ruling Mr. Hayslip stated that the Committee was pleased that the ERCOT budgeting process was getting better each year and that ERCOT would continue its efforts to improve communication with the PUC to align philosophies regarding the budget and fee.

Nodal Funding Update

Cheryl Yager reviewed the status of the Nodal Surcharge filing. Ms. Yager confirmed that ERCOT had filed a request to begin recovery of an interim surcharge to begin funding the Nodal Market Redesign project at the rate of \$.0663, and that no settlement had been reached. Ms. Yager informed the Committee that the hearing on the Nodal Surcharge was set for July 21, 2006. Ms. Yager explained that the spending needs for Nodal will drive ERCOT's need to increase available liquidity to remain compliant with ERCOT Financial policy, and that staff is currently refining forecast of amount of liquidity required to fund the Nodal project. Ms. Yager indicated that staff would present various options for the Committee's consideration during the 3rd quarter.


Future Agenda Items and Other Topics

Steve Byone informed the Committee that ERCOT needed request authorization from the PUC for a "Special Fee" to enable ERCOT to bill Entergy for costs incurred in connection with the interconnection study requested by the Commission. Mr. Byone confirmed that ERCOT is incurring costs to conduct the study but is not currently authorized to seek reimbursement for the work directed by the Commission. Accordingly, ERCOT expects to prepare a filing for the Special Fee in the next few weeks. Mr. Byone stated that staff had informed him that they expected to expend less than \$100,000 on the study.

Mr. Byone informed the Committee that the prioritization of projects in TAC was on schedule. Mr. Espinosa stated that the constant of \$25 million did seem suspect and would like to determine how best to approach the project budgeting.

Adjournment

At approximately 9:10 A.M., the meeting was adjourned and the Committee went into Executive Session. The next regularly scheduled meeting will be held on the morning of July 18, 2006.



Susan Vincent, Secretary