

MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Met Center

7:45 A.M.

October 17, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 7:45 A.M. on **October 17, 2006**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

Meeting Attendance

Committee members:

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Present
Miguel Espinosa, Vice Chair	Independent Board Member	Independent Board Member	Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present
William Taylor	Calpine Corporation	Ind. Generator	Present

ERCOT staff and guests present:

Anderson, Troy	ERCOT
Barry, Sean (via phone)	PriceWaterhouseCoopers (PwC)
Berry, Ron	ERCOT
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Day, Betty	ERCOT
Doolin, Estrellita	ERCOT
Dreyfus, Mark	Austin Energy
Hancock, Misti	ERCOT
Hudson, Paul	PUCT
Jones, Sam	ERCOT (CEO)
Meek, Don	ERCOT
Petterson, Mike	ERCOT
Ruebsahm, Jamille	Deloitte & Touche (D&T)
Troxell, David	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Wullenjohn, William	ERCOT
Yager, Cheryl	ERCOT

Executive Session

At 7:46 AM, the Committee meeting was adjourned and the Committee went into Executive Session until approximately 8:40 AM. The Committee returned to Open Session at 8:45 AM.

Approval of Previous Minutes

Robert Manning moved to approve the minutes for the previous meetings held on September 19, 2006 and October 5, 2006; Miguel Espinosa seconded the motion. The motion passed unanimously.

2007 Operating Budget

Michael Petterson confirmed for the Committee the rigorous process of review of the proposed 2007 Operating Budget process to date, including review by and input from the public, market participants, PUCT staff, the Committee, and the ERCOT Board of Directors. Mr. Petterson overviewed the 2007 Budget objectives and assumptions and reviewed the proposed budget, including certain previously scrutinized expense items, outside services increase due to Nodal backfill by consultants, a comparison of the proposed budget to the 2004 to 2006 budgets, and a proposed 5-year forecast, all of which were set to be presented to the full Board. After discussions by the Committee members, Clifton Karnei confirmed that the Committee had reviewed the 2007 budget, generally concurred with management's recommendations and intended to make a recommendation regarding approval to the full Board during its November meeting. However, Mr. Byone and Mr. Karnei stated that they first wanted to discuss increasing the 2006 capital budget.

2006 Capital Budget Increase

Steve Byone explained that subsequent to an ERCOT staff review of the applications and systems that needed upgrade or other modification for the Texas Nodal Market Implementation Program, there was an outstanding question as to the inclusion of certain items in the Nodal budget. The items in question are critical path for Nodal and have been included in the Nodal program estimates although they were previously planned to be addressed (in later years) within the zonal capital program. Mr. Byone informed the Committee that management believes the interim surcharge Order contemplates separate accounting of specific Nodal costs versus costs that would be incurred under zonal. Mr. Byone stated that, based upon the analysis, ERCOT management suggested that \$37 million of the proposed Nodal budget be reclassified to be a part of the traditional zonal capital projects budget ("Zonal").

Mr. Byone presented a proposal for implementing management's suggestion to reclassify the \$37 million by: 1) Re-prioritizing Zonal project plans where possible, 2) Using anticipated 2006 "excess revenue" to fund project additions, 3) Temporarily decreasing 2007 equity contribution from 40% to 27%, and 4) Reducing 2008 Zonal project spending so that the overall (2006-2008) equity contribution target of 40% would be restored.

Mr. Byone explained that the proposed action would accommodate Nodal critical path items, maintain ERCOT's overall credit quality, and maintain a stable System Administration Fee in 2007 and 2008. He told the Committee that expected completion of items totaling \$9.3 million in 2006 would require a 2006 spending increase, and that management would be seeking approval of this 2006 capital budget increase at the October Board meeting. Mr. Byone also stated that he would seek to have the Committee indicate approval of the 2007 Budget at the meeting but that no formal vote would be taken on the 2007 Budget until November.

Scott Gahn indicated support to reducing the equity percentage, temporarily, and asked Mr. Byone to confirm that non-Nodal staff members were involved in the reprioritization. Mr. Karnei asked if the Committee wanted to recommend the 2007 Budget at the upcoming meeting. William Taylor and Mr. Gahn questioned whether the Committee should wait until the November meeting to make a recommendation to determine if there was any change to the proposed \$37 million reclassification. The Committee members indicated that they desired to retain a flat system administration fee. Robert Manning indicated that he would like to approve the 2007 Budget, and

Tom Standish stated that, although he didn't necessarily agree with the plan, he would agree to staff's financing proposal.

After extensive discussion, **William Taylor moved to recommend approval of the 2006 Capital Budget Increase of \$9.3 million; Robert Manning seconded the motion. The motion passed unanimously.**

Treasury and Credit Update

Cheryl Yager presented to the Committee a Summary of Investment Results for the third quarter of 2006. She also informed the Committee that Moody's had reviewed its rating of ERCOT and had confirmed the current rating.

Ms. Yager updated the Committee on efforts to provide credit insurance coverage for the ERCOT market. Staff sought bids from five companies and continues discussion with two entities, one of which is fairly active at this time. She highlighted the parameters requested and the general pricing discussed with the vendor. She noted that all vendors had indicated that not all QSEs would be covered and that all vendors had cancellation clauses that would allow them to discontinue coverage on individual QSEs within certain notice timeframes. After some discussion, the Committee requested staff to provide more information so it could continue the discussions regarding the number of entities that the insurance would currently exclude, the notice required for and timing of future cancellations, how to fund the premium, and other related issues.

Ms. Yager noted that PRR 683, which was proposed by the Credit Work Group at the Committee's request, had been rejected by PRS. PRR 683 sought to reduce the timeline for notice and cure and create a working credit limit. TAC took no follow-up action. Staff interpreted the vote as acceptance by market participants of the residual credit exposure in the market. Mr. Karnei asked whether the Committee wanted to take action to reduce the credit risk. Mr. Taylor and Mr. Gahn noted that the market had clearly agreed to the current credit risk. After extensive discussion, the Committee asked staff to investigate possibly engaging a credit professional to assess the reasonableness of ERCOT's credit exposure policies and to bring further information to the Committee for review.

Ms. Yager updated the Committee on other Credit Work Group and credit staff projects including the following:

1. Reviewing business requirements for credit monitoring system for Nodal
2. Reviewing credit standards
3. Reviewing Credit Work Group charter
4. On-going review of PRRs
5. Automation of credit calculations

Discussion on Materiality Levels

Michael Petterson reviewed the benefits of establishing materiality levels and sought concurrence from the Committee regarding concepts of materiality that would promote more efficient design of a risk-based internal control program. Sean Barry of PwC agreed that this effort was a good idea and that it was best practice for the Committee and the Finance staff to agree on this topic. Mr. Barry also cautioned the Committee to avoid "pinning" itself down since materiality analyses are fact and circumstance driven. Mr. Barry and Bill Wullenjohn noted that internal audit and external auditors would have different thresholds for materiality, with internal audit using a lower threshold and external auditors using a higher threshold before disclosure. The Committee suggested staff prepare a document describing the materiality approach including relevant caveats.

Committee Briefs

Project Cancellation and Write-Off

Michael Petterson explained that the Outage Scheduler Enhancements Phase 2 Project had been cancelled and that 2006 operating expenses would be increased by \$705,000. Committee members requested that the business owner (S. Myers) and/ or sponsor (K. Saathoff) be invited to a future meeting to explain the rationale for the cancellation.

Potential Conflicts – Market Participant Banks

Cheryl Yager requested the Committee to consider discussing during a future meeting the potential conflict or market participants that provide banking services to ERCOT.

Adjournment

At approximately 9:59 A.M., the meeting was adjourned. The next Committee meeting will be held on the morning of November 14, 2006.



Susan Vincent, Secretary