

**The Finance & Audit (F&A) Committee is  
expected to consider  
F&A Committee Agenda Item 5:**

***Recommendation Regarding Financial  
Corporate Standard***

**at its meeting on April 18, 2016.**

**The Board of Directors is expected to hear  
the F&A Committee's recommendation on  
this matter as part of the F&A Committee  
Report at the Board meeting  
on April 19, 2016.**

**Attached are the Board materials in relation  
to these agenda items.**



## **Item 5: Recommendation Regarding Financial Corporate Standard**

*Leslie Wiley*  
Treasurer

Finance & Audit Committee

ERCOT Public  
April 18, 2016

# Financial Corporate Standard

- The objective of the Financial Corporate Standard is to assure financial stability.
- The Board of Directors annually reviews and approves the Financial Corporate Standard.
- ERCOT is seeking a vote from Finance and Audit Committee members to recommend the Board of Directors approve the Financial Corporate Standard.

## Debt Strategy Direction

- Debt is an appropriate means to help maintain stable, fair and predictable fees.
- Debt capacity may be used to ensure adequate liquidity for business needs.
- Cash reserves should not be accumulated to ensure adequate liquidity for business needs.

## Debt Strategy Direction

- ERCOT's "Aa3" Moody's credit rating should be maintained to ensure debt can be acquired at favorable interest rates.
- CRR Auction Receipts represent an attractive, low-cost funding option but given uncertainty regarding continued availability, CRR Auction Receipts should be fully backed up by unused borrowing capacity.

## Debt Strategy Direction

- Debt should be repaid over the useful life of the assets acquired or constructed with the borrowed funds.
- Variable rate debt is an acceptable funding source for hardware, software, and other technology assets typically possessing useful lives of five years or less.
- Variable interest rate risk exposure should be carefully monitored.

## Debt Strategy Direction

- Finance & Audit Committee members will approve funding sources for significant unbudgeted initiatives on a case-by-case basis.

## Vote

- ERCOT is seeking a vote from Finance and Audit Committee members to recommend the Board of Directors adopt ERCOT's Financial Corporate Standard.





**Date:** April 12, 2016  
**To:** Board of Directors  
**From:** Jorge Bermudez, Finance and Audit (F&A) Committee Chairman  
**Subject:** Financial Corporate Standard

**Issue for the ERCOT Board of Directors**

**ERCOT Board of Directors Meeting Date:** April 19, 2016

**Item No.:** 9.2

**Issue:**

Whether the Board of Directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) should approve any or all of the ERCOT-staff proposed modifications or recommend and approve any other changes to the ERCOT Financial Corporate Standard (Standard), to become effective upon approval by the Board.

**Background/History:**

The Board has established a Financial Corporate Standard, which is reviewed annually and updated as needed. The Board must approve any modifications to the document.

This Standard establishes a framework from which ERCOT's financial integrity is maintained while serving the long-term interests of the company and the ERCOT market. ERCOT recognizes that maintaining financial integrity is critical to accomplishing its corporate goals and discharging ERCOT's primary responsibilities.

ERCOT staff has reviewed the Standard and proposes several changes and clarifications, as reflected in Attachment A, to become effective upon approval by the Board. These changes mainly relate to ERCOT's debt strategy and are based in part on input received from the Finance and Audit (F&A) Committee following discussion at its February 8, 2016 meeting. The F&A Committee is expected to recommend the Board adopt, reject, or amend the Standard at its April 18, 2016 meeting. For convenience, a clean version of the revised charter has been attached as Attachment B.

**Key Factors Influencing Issue:**

The key factors influencing the issue are adherence to provisions of Board-approved corporate standards, improved clarity and consistency of policy documents, and the need to provide sound financial guidance for ERCOT's exempt purposes.

**Conclusion/Recommendation:**

The F&A Committee will review the ERCOT staff-proposed modifications at its meeting on April 18, 2016 and is expected to recommend to the Board whether any revisions should be made to the Standard and whether they should become effective upon approval by the Board.



**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 revise the ERCOT Financial Corporate Standard (the Standard), as recommended by the Finance and Audit (F&A) Committee, consistent with the revisions reflected in Attachment A hereto;

THEREFORE, BE IT RESOLVED, that ERCOT is hereby authorized and approved to revise the Standard consistent with the revisions reflected in Attachment A, to be effective immediately.

**CORPORATE SECRETARY'S CERTIFICATE**

I, Vickie G. Leady, Assistant Corporate Secretary of ERCOT, do hereby certify that, at its April 19, 2016 meeting, the ERCOT Board passed a motion approving the above Resolution by \_\_\_\_\_.

IN WITNESS WHEREOF, I have hereunto set my hand this \_\_\_ day of \_\_\_\_\_, 2016.

\_\_\_\_\_  
Vickie G. Leady  
Assistant Corporate Secretary

**ERCOT CORPORATE STANDARD**

Document Name:	Financial Corporate Standard
Document ID:	CS3.1
Effective Date:	<del>February 27, 2015</del> Upon Approval
Owner:	Board of Directors, Finance & Audit Committee
Governs:	ERCOT Personnel
Approved:	Board of Directors, Finance & Audit Committee

**1. PURPOSE**

This ~~financial~~ Financial Corporate Standard is a framework from which ERCOT's financial integrity will be maintained while serving the long-term interests of the company and the ERCOT market. ERCOT recognizes that maintaining financial integrity is critical to accomplishing its corporate goals and discharging ERCOT's primary responsibilities.

## 2. DEFINITIONS

Acronyms & Terms	Definition and Description
<b>Budget</b>	<del>The Budget consists of Project Budgets and an Operating and Maintenance Budget-ERCOT's biennial budget.</del>
<b>Project Budgets</b>	<del>Project Budgets consist of proposed expenditures to be made to develop capital assets during ERCOT's Fiscal Year. Any significant projects not included in the approved project budgets will be presented to ERCOT's Board of Directors for approval as they arise.</del>
<b>Cash Operating and Maintenance Expenses</b>	Cash Operating and Maintenance Expenses consist of all reasonable and necessary costs (excluding non-cash items such as depreciation and amortization) incurred in the operation and maintenance of ERCOT's facilities, equipment and systems.
<b>Fiscal Year</b>	ERCOT's fiscal year is January 1 <sup>st</sup> through December 31 <sup>st</sup> .
<b>NERC</b>	North American Electric Reliability Corporation, the entity currently certified as the Electric Reliability Organization by the Federal Energy Regulatory Commission ("FERC").
<b>Operating and Maintenance Budget</b>	<del>The Operating and Maintenance Budget consists of all reasonable and necessary costs expected to be incurred during ERCOT's Fiscal Year.</del>
<b>Scheduled Debt Service</b>	<del>Scheduled Debt Service is all interest and mandatory principal payments due on ERCOT's outstanding indebtedness (both long-term and short-term) for a stated period.</del>
<b>Strategic Financial Plan</b>	<del>The Strategic Financial Plan will provide current financial information and a five-year projection, which addresses all sources of revenues, including any proposed fee adjustments. It will include projections of operating and maintenance expenses, project expenditures, the funding sources of project expenditures, and debt service requirements as well as the resulting capital structure.</del>
<b>Congestion Revenue Right (CRR) Auction Receipts</b>	Funds received, held, and redistributed by ERCOT in connection with periodic auctions by ERCOT that allow eligible CRR account holders to buy and sell CRRs. Congestion Revenue Rights

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## 3. FINANCIAL OBJECTIVES

In seeking to fulfill its corporate objectives, ERCOT will maintain a high level of financial stability and will not compromise long-term financial integrity to achieve short-term benefits.

### Fees

ERCOT will seek to maintain stable, fair, and predictable fees. ERCOT will also endeavor to provide market participants as much advance notice as practicable before fee changes are proposed or enacted.

### Liquidity

ERCOT will seek to maintain adequate liquidity to meet its business needs. Liquidity is the combination of available 1) operating cash on hand, 2) operating cash equivalents / short term investments, and 3) undrawn borrowing capacity under credit facilities.

## Attachment A

ERCOT's targeted minimum level of liquidity will factor in: 1) six months of all forecasted interest and mandatory principal payments on outstanding indebtedness, other than principal payments reasonably expected to be refinanced, 2) two months of average Cash Operating and Maintenance Expenses, net of projected administrative fee receipts, 3) two months of budgeted project expenditures, and 4) all CRR Auction Receipts used to fund ERCOT operations.

If at any time ERCOT's liquidity is less than, or is expected to be less than, the targeted minimum level set forth in this Financial Corporate Standard, staff will promptly recommend a plan for Board of Director (Board) consideration to achieve the liquidity target within six months.

### **Debt Rating**

ERCOT will pursue financial objectives that will allow it to maintain the Aa3 Moody's rating or equivalent debt rating with Standard & Poor's or Fitch. If a rating below the Aa3, or equivalent, current rating is received, staff will promptly recommend a plan for Board consideration to attempt to recover the targeted rating within 18 months.

## **4. FUNDING SOURCES**

ERCOT may use a combination of self-funding, CRR Auction Receipts, and debt to fund current year expenditures and provide targeted minimum level of liquidity.

### **Self-Funding**

ERCOT will assess fees consistent with the ERCOT Protocols and Public Utility Commission of Texas rules. ERCOT will also collect fees on behalf of the Electric Reliability Organization as approved by the Federal Energy Regulatory Commission. Fee adjustments, if necessary, will generally be developed and proposed in connection with the Budget.

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ERCOT will not accumulate cash reserves to meet the targeted minimum level of liquidity without sufficient economic justification and preapproval of the Board.

### **CRR Auction Receipts**

CRR Auction Receipts may be used to fund ERCOT operations to the lesser of limits imposed by debt covenants or 50 percent of total CRR Auction Receipts held.

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Given uncertainty regarding availability of CRR Auction Receipts, ERCOT will maintain unused debt capacity to the full extent CRR Auction Receipts are used to fund ERCOT operations.

### **Debt**

Generally, ERCOT will structure debt issues such that the average maturity of the debt does not exceed the average life of the assets financed; however, debt issues may be structured with a longer or shorter average maturity if economically justified.

## Attachment A

ERCOT may use variable-rate debt to fund acquisitions of hardware, software and other technology assets to provide flexibility in its financing program and to help stabilize fees.

ERCOT will regularly evaluate the interest rate environment and review ways to manage interest rate risk exposure within that environment.

As appropriate, ERCOT will periodically evaluate mechanisms to restructure or refinance debt. ERCOT will regularly evaluate alternatives to conventional financing to obtain the lowest overall cost of borrowing while still meeting the objectives of this Financial Corporate Standard.

### **5. BUDGET**

In developing the Budget, ERCOT will work to ensure that financial ratios required for compliance with loan documents and the financial objectives in this Financial Corporate Standard are maintained.

#### **Budget Variances**

ERCOT will use all reasonable means to operate within the approved Budget. When unforeseen events occur (e.g., MWh's are significantly over or under projected levels, functionality is added or removed, etc.) and ERCOT experiences, or expects to experience, any overspending of the Budget or under collection of revenue, or more than a five percent under-spending of the Budget or over collection of revenue, staff will promptly recommend a plan for Board consideration. The plan may include cost reductions or additions, fee increases or decreases, or other means to ensure that approved functions can be maintained, capital expended and expenses paid in the normal course of business.

#### **Unbudgeted Initiatives**

In the event that ERCOT has significant unbudgeted initiatives, funding will be addressed at the time of initiation with Finance and Audit Committee approval.

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~~Strategic Financial Plan and Budget~~—Prior to or in conjunction with the submission of the Budget, the Vice President and Chief Financial Officer or Controller will submit an update to the Strategic Financial Plan.

The Budget will be substantially consistent with the Strategic Financial Plan and will be submitted to the Board with sufficient time for the review and approval prior to the beginning of the Fiscal Year.

In developing the Strategic Financial Plan and Budget, ERCOT staff will work to ensure that financial ratios required for compliance with debt instruments are maintained.

ERCOT will pursue financial objectives that will allow it to maintain an investment grade debt rating with Standard & Poor's, Moody's or Fitch. If a rating below investment grade

## Attachment A

is received or expected to be received, staff will promptly recommend a plan for Board consideration to recover or maintain the targeted rating within 18 months.

Overall, the Strategic Financial Plan and the related Budget will seek to assure ERCOT's financial stability. They will be approved by the Board and will guide ERCOT's financial planning process.

**Fees and Charges**—ERCOT will assess fees consistent with the ERCOT Protocols and Public Utility Commission of Texas rulings. ERCOT will also collect fees on behalf of the Electric Reliability Organization as approved by FERC. Fees, funding, and charges will be requested to recover the Board-approved Operating and Maintenance Budget (excluding depreciation and amortization), Scheduled Debt Service (less any principal payments reasonably expected to be refinanced), and the portions of Project Budgets that are to be self-funded. Fee adjustments, if necessary, will generally be developed and proposed in connection with ERCOT's annual Budget.

ERCOT will use all reasonable means to operate within the approved Budget for the current year. When unforeseen events occur (e.g., MWh's are significantly over or under projected levels, functionality is added or removed, etc.) and as a result, ERCOT experiences or expects to experience in the next 12-month period any overspending of the Budget or under collection of revenue, or more than a 5 percent under spending of the Budget or over collection of revenue, staff will promptly recommend a plan for Board consideration, which may include cost reductions or additions, fee increases or decreases, or other means to ensure that approved functions can be maintained, capital expended and expenses paid in the normal course of business.

**Sources of Financing**—ERCOT may use a combination of equity (self-funding) and debt to finance current year Project Budgets. In determining the combination of equity and debt to be used, ERCOT will consider the impact of the current year decision on future years, but in no event will ERCOT propose to self-fund less than 40 percent of Project Budgets during the project development phase.

Generally, ERCOT will structure debt issues such that the average maturity of the debt does not exceed the average life of the assets financed; however, debt issues may be structured with a longer or shorter average maturity if economically justified.

ERCOT may use variable-rate debt to provide flexibility in its overall financing program and to manage its overall interest rate exposure. However, in no event will ERCOT allow un-hedged, variable rate debt to be more than 40 percent of total debt outstanding.

ERCOT will periodically evaluate the interest rate environment and review ways to manage interest rate exposure within that environment.

As appropriate, ERCOT will periodically evaluate mechanisms to restructure or refinance debt. ERCOT will regularly evaluate alternatives to conventional financing to obtain the lowest overall cost of borrowing while still meeting the objectives of this financial Corporate Standard.

~~Liquidity~~—ERCOT will seek to maintain adequate liquidity to meet its business needs. Liquidity is the combination of available 1) operating cash on hand, 2) operating cash equivalents / short term investments and 3) undrawn borrowing capacity under credit facilities.

~~ERCOT's targeted minimum level of liquidity will factor in: 1) six months of forecasted Scheduled Debt Service, other than principal payments reasonably expected to be refinanced, 2) two months of average Cash Operating and Maintenance Expenses, net of projected administrative fee receipts, 3) two months of budgeted project expenditures, and 4) to the extent CRR auction revenues have been utilized to fund ERCOT working capital and project expenditure needs, two months of estimated CRR repayment obligations expected to be paid, net of projected CRR auction receipts during the same period.~~

~~If at any time ERCOT's liquidity is less than or is expected to be less than the targeted minimum level set forth in this Corporate Standard, staff will promptly recommend a plan for Board consideration to achieve the liquidity target within six months.~~

~~Funds received in conjunction with CRR auctions may be utilized to fund ERCOT working capital and project expenditure needs so long as liquidity is at or above the target levels and ERCOT's issuer rating remains investment grade. These funds may be utilized in place of borrowing under short term credit facilities to meet liquidity needs.~~

#### **4.6. RESPONSIBILITIES**

It is the responsibility of the Chief Executive Officer and Vice President and Chief Financial Officer to ensure that this Financial Corporate Standard is implemented appropriately and to recommend changes in the Financial Corporate Standard as needed.



**5.7. FINANCIAL CORPORATE STANDARD ADOPTION**

~~ERCOT's Financial Corporate Standard was adopted by resolution of the Board of Directors.~~ The Financial Corporate Standard will be reviewed annually by the Finance and Audit Committee and any modifications made thereto must be approved by the Board of Directors.

## ERCOT CORPORATE STANDARD

Document Name:	Financial Corporate Standard
Document ID:	CS3.1
Effective Date:	Upon Approval
Owner:	Board of Directors, Finance & Audit Committee
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## **7. FINANCIAL CORPORATE STANDARD ADOPTION**

The Financial Corporate Standard will be reviewed annually by the Finance and Audit Committee and any modifications made thereto must be approved by the Board.