Item 9.3: Review of Audited Financial Statements

Sean Taylor
Controller

Finance & Audit Committee Meeting

ERCOT Public
April 3, 2017

ercot
Your Power. Our Promise.

Financial Statements

Electric Reliability Council of Texas, Inc.
Years ended December 31, 2016 and 2015
With Report of Independent Auditors

April 2017

Electric Reliability Council of Texas, Inc.

Financial Statements

December 31, 2016 and 2015

Contents

PRELIMINARY AND TENTATIVE FOR DISCUSSION ONLY

Baker Tilly Virchow Krause, LLP
2801 Via Fortuna
Suite 300
Austin, TX 78746
tel 608 249 6622
fax 608 249 8532
bakertilly.com

INDEPENDENT AUDITORS' REPORT

The Finance and Audit Committee
Electric Reliability Council of Texas, Inc.
Austin, Texas

We have audited the accompanying financial statements of the Electric Reliability Council of Texas, Inc. ("ERCOT"), which comprise the statements of financial position as of December 31, 2016 and 2015, and the related statements of activities and net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

The Finance and Audit Committee

Electric Reliability Council of Texas, Inc.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ERCOT as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Austin, Texas

April 5, 2017

Electric Reliability Council of Texas, Inc.

Statements of Financial Position

	December 31 2016	December 31 2015
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 307,091	$ 307,353
Accounts receivable	4,400	2,259
Unbilled revenue	3,163	2,379
Restricted cash and cash equivalents	387,185	363,549
Prepaid expenses and other current assets	21,635	17,042
Total current assets	723,474	692,582
Property and equipment, net	109,014	99,116
Systems under development	15,869	19,359
Total assets	$ 848,357	$ 811,057
Liabilities and unrestricted net assets		
Current liabilities:		
Accounts payable	$ 2,427	$ 3,628
Accrued liabilities	11,773	8,579
Deferred revenue	4,203	3,866
Market settlement liabilities	342,869	356,687
Security deposits	387,185	363,549
Notes payable, current portion	4,000	4,000
Total current liabilities	752,457	740,309
Notes payable, less current portion:		
Principal	59,000	63,000
Less unamortized debt issuance costs	213	221
Notes payable, less current portion and unamortized debt issuance costs	58,787	62,779
Other long-term liabilities	375	352
Total liabilities	811,619	803,440
Unrestricted net assets	36,738	7,617
Total liabilities and unrestricted net assets	$ 848,357	$ 811,057

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Activities and Net Assets

	Year Ended December 31 2016	2015
	(In Thousands)	
Operating revenues:		
System administration fees	$ 196,035	$ 162,020
Reliability organization pass-through	13,977	14,704
Other services revenue	5,069	4,287
Total operating revenues	215,081	181,011
Operating expenses:		
Salaries and related benefits	97,169	98,646
Hardware and software maintenance and licensing	24,745	19,757
Outside services	10,650	9,957
Facility and equipment costs	9,848	9,576
Reliability organization assessment	13,977	14,704
Depreciation	21,727	55,443
Amortization of regulatory liability	-	(33,526)
Other	6,599	6,759
Total operating expenses	184,715	181,316
Income/(loss) from operations	30,366	(305)
Other income (expense):		
Interest income	559	40
Interest expense	(1,934)	(2,103)
Non-operating income	130	364
Change in unrestricted net assets	29,121	(2,004)
Unrestricted net assets, beginning of year	7,617	9,621
Unrestricted net assets, end of year	$ 36,738	$ 7,617

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows

	Year Ended December 31 2016	2015
	(In Thousands)	
Operating activities		
Change in unrestricted net assets	$ 29,121	$ (2,004)
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities:		
Depreciation	21,727	55,443
Amortization of regulatory liability	-	(33,526)
Amortization of debt issuance costs	17	32
Net gains on capital assets	(113)	(315)
Changes in operating assets and liabilities:		
Accounts receivable	(2,141)	965
Unbilled revenue	(784)	(69)
Prepaid expenses and other assets	(4,593)	(716)
Other long-term liabilities	23	(77)
Accounts payable	(305)	(169)
Accrued liabilities	3,429	(722)
Deferred revenue	337	(312)
Net cash provided by operating activities	46,718	18,530
Investing activities		
Capital expenditures for property and equipment and systems under development	$ (29,154)	$ (25,842)
Proceeds from sale of property and equipment	1	5
Net cash used in investing activities	(29,153)	(25,837)

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows (continued)

	Year Ended December 31	
	2016	2015
	(In Thousands)	
Financing activities		
Repayment of notes payable	$ (4,000)	$ (4,000)
Payment of debt issuance costs	(9)	(9)
(Increase) decrease in restricted cash	(23,636)	45,463
(Decrease) increase in market settlement liabilities	(13,818)	3,868
Increase (decrease) in security deposits	23,636	(45,463)
Net cash used in financing activities	(17,827)	(141)
Net decrease in cash and cash equivalents	(262)	(7,448)
Cash and cash equivalents, beginning of year	307,353	314,801
Cash and cash equivalents, end of year	$ 307,091	$ 307,353
Supplemental information		
Cash paid for interest	$ 2,156	$ 2,199
Supplemental disclosures of non-cash investing and financing activities		
Change in accrued capital expenditures	$ (1,131)	$ 364
Capitalized interest	$ 507	$ 462

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements
(Dollars in Thousands)

December 31, 2016 and 2015

1. Organization and Operations

Electric Reliability Council of Texas, Inc. (ERCOT or the Company) is a Texas, non-profit corporation. ERCOT functions as the independent system operator for its reliability region, which comprises about 90% of the electrical load in Texas. The ERCOT region has more than 78,000 megawatts of available capacity for the summer peak demand period.

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 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 directors (15 voting and one non-voting). Six of the voting directors represent segments of industry in the ERCOT electricity market, that is, cooperative, independent generator, independent power marketer, independent retail electric provider, investor-owned utility, and municipal. The remaining ten seats on the board are filled by two consumer directors (commercial and industrial), five unaffiliated directors, and three ex-officio directors, that is, the Public Counsel as a third consumer Director (residential), the non-voting Chair of the PUCT, and ERCOT's Chief Executive Officer. The six "market segment directors" and two of the consumer directors (commercial and industrial) each have an elected alternate (segment alternate) who can attend meetings and vote in the absence of the market segment director.

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

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.

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.

Reclassification of Prior Year Presentation

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations.

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents consist of deposits in banks and money market investment accounts with original maturities of 90 days or less.

Cash and cash equivalents consist 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 and Cash Equivalents

Restricted cash and cash equivalents consist of deposits in banks and money market investment accounts with original maturities of 90 days or less.

Restricted cash and cash equivalents primarily represent amounts received for security deposits from ERCOT's market participants.

Accounts Receivable and Revenue Recognition

System administration fees – ERCOT funds its operations primarily through a system administration fee (SAF) collected from electric service providers operating within the Texas grid. This fee is charged pursuant to the ERCOT protocols and as approved by both the ERCOT board of directors and the PUCT. It is based on actual volume consumption. Revenue from the SAF is recognized in the period that the underlying energy transaction occurs. Amounts not yet billed are accrued and presented as unbilled revenue on the statements of financial position. The SAF was 55.5 cents and 46.5 cents per megawatt hour of adjusted metered load in 2016 and 2015, respectively. It is structured to provide funding for ERCOT's core operations and related services.

Reliability organization pass-through – The North American Electric Reliability Corporation (NERC) invoices ERCOT for reliability functions performed primarily by Texas Regional Entity, Inc. In turn, ERCOT collects revenue from market participants for this Electric Reliability Organization (ERO) billing. The ERO billing is based on actual NERC funding, and ERCOT collects this revenue and remits it to NERC on a quarterly basis.

2. Summary of Significant Accounting Policies (continued)

Other services revenue – ERCOT's other revenue relates to services offered to its participants, including connectivity to ERCOT's grid, wide-area network usage, training for market participants, 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.

Property and Equipment

Property and equipment consist primarily of computer equipment, software, and buildings for operations and are recorded at cost. Depreciation is computed on the straight-line method 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 non-operating income (expense) in the statement of activities and net assets for the period. The Company recognized a gain of $113 and $315 in 2016 and 2015, respectively, related to property and equipment. Repairs and maintenance costs are expensed when incurred.

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

Asset Category	Depreciable Life
Computer hardware	3
Software	5
Vehicles	5
Furniture and Equipment	7
Mechanical building components	10
Buildings	30
Leasehold improvements	Lesser of useful life or respective lease term

2. Summary of Significant Accounting Policies (continued)

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. 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.

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 2016 or 2015.

Interest Capitalization

Interest is capitalized in connection with the construction of major software systems, 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 2016 and 2015, capitalized interest costs were $507 and $462, 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 15 days before distribution to the market in accordance with timetables set forth in ERCOT's Protocols.

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

ERCOT manages a congestion revenue rights (CRR) program that includes monthly auctions and auctions for longer than one month. 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 a certain portion of the funds held as a result of CRR auctions may be used to fund ERCOT working capital and capital expenditure needs within certain guidelines.

Market settlement liabilities consist of the following at December 31:

	2016	2015
CRR auction funds	$ 268,368	$ 293,809
Prepayments of settlement obligations	74,501	62,878
Total market settlement liabilities	$ 342,869	$ 356,687

Security Deposits

Market participants not meeting certain creditworthiness standards referenced in ERCOT Protocols must maintain a means of security with ERCOT in order to mitigate market credit risk. Market participants have discretion in the means of security, such as corporate guaranties, letters of credit, surety bonds, or cash security deposits provided the market participants remain in compliance with ERCOT Protocols. ERCOT is required to remit interest earned on security deposits to market participants.

Cash security deposits are classified as restricted cash on the Statements of Financial Position. The balance of cash security deposits is $387,185 and $363,549 at December 31, 2016 and 2015, respectively.

2. Summary of Significant Accounting Policies (continued)

Income Taxes

ERCOT is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(4). The Company is also exempt from state income taxes. Accordingly, no provision for income taxes or uncertain tax positions has been reflected in the financial statements.

Debt Issuance Costs

ERCOT capitalizes issuance costs related to debt. The amounts are amortized over the life of the debt.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No.2015-03 requiring debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from that debt liability. The ASU is effective for financial statements issued for fiscal years beginning after December 15, 2015. ERCOT adopted the amendments in this Update in its 2016 financial statements.

Adoption of Accounting Standards Update (ASU)

The FASB issued ASU No. 2014-09 Revenue from Contracts with Customers, ASU No. 2016-02 Leases, ASU No. 2016-12 Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients, ASU No. 2016-14 Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities, and ASU No. 2016-18 Statement of Cash Flows: Restricted Cash. ERCOT will adopt the amendments in these updates when they are effective.

The FASB issued ASU No. 2016-01 Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. This update is intended to improve the recognition and measurement of financial instruments and eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. The new guidance permits entities that are not public entities to adopt upon issuance the provision that eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost.

2. Summary of Significant Accounting Policies (continued)

ERCOT elected to adopt this provision in its 2016 financial statements (as reflected in Note 3 - Fair Value Measurement).

Accounting for the Effects of Regulation

ERCOT is subject to the provisions of the FASB 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.

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, which 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. The fair value on a recurring basis as of December 31 is as follows:

	2016			
	Total	Level 1	Level 2	Level 3
Assets				
Cash and cash equivalents	$ 307,091	$ 307,091	$ -	$ -
Restricted cash and cash equivalents	387,185	387,185	-	-
Total assets	$ 694,276	$ 694,276	$ -	$ -

	2015			
	Total	Level 1	Level 2	Level 3
Assets				
Cash and cash equivalents	$ 307,353	$ 307,353	$ -	$ -
Restricted cash and cash equivalents	363,549	363,549	-	-
Total assets	$ 670,902	$ 670,902	$ -	$ -

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)
(Dollars in Thousands)

December 31, 2016 and 2015

4. Property and Equipment

Property and equipment consist of the following at December 31:

	2016	2015
Depreciable:		
Software	$ 645,801	$ 623,065
Building and leasehold improvements	90,861	90,569
Computer hardware and equipment	89,536	85,593
Furniture and fixtures	33,896	33,564
Vehicles	118	118
Non-depreciable:		
Land	947	947
	861,159	833,856
Accumulated depreciation	(752,145)	(734,740)
	109,014	99,116
Systems under development	15,869	19,359
Total property and equipment, net	$ 124,883	$ 118,475

5. Notes Payable

ERCOT's notes payable consist of the following:

	2016	2015
3.00% senior notes	$ 63,000	$ 67,000

5. Notes Payable (continued)

Revolving Line of Credit

ERCOT has one revolving line of credit with JPMorgan Chase Bank that was entered into in June 2012, amended in December 2013, and amended again in December 2015. This facility is primarily used for short-term working capital needs, has a maximum amount of available credit of $125,000, and expires on December 31, 2017. As of December 31, 2016 and 2015, there was no debt outstanding under this line of credit.

The interest rate on this facility is based on the prime rate, a Eurodollar based rate, or other rate as described in the debt agreements. The contractual rate of interest on the revolving line of credit's outstanding balance was 1.37% at December 31, 2016. Additionally, at December 31, 2016, ERCOT pays a commitment fee of 0.12% on the unused portion of the $125,000 revolving credit facility. ERCOT incurred commitment fees totaling $152 in both 2016 and 2015, in connection with its debt facilities. The revolving line of credit has several debt covenants, the most restrictive of which limits ERCOT's indebtedness. At December 31, 2016 and 2015, the revolving line of credit had unamortized debt issuance costs of $5 and $0, respectively. ERCOT was in compliance with its debt covenants for this facility.

3.00% Senior Notes

On October 31, 2012, ERCOT issued $80,000 in senior notes through a private placement. These notes bear interest at 3.00% and are due in equal quarterly principal payments beginning in December 2012 through September 2032. The private placement has several covenants, the most restrictive of which limits ERCOT's indebtedness. At December 31, 2016 and 2015, there were $63,000 and $67,000 outstanding senior notes, respectively and, $208 and $221 of unamortized debt issuance costs, respectively. ERCOT was in compliance with its covenants for these notes.

(Dollars in Thousands)

5. Notes Payable (continued)

Future Maturities

Future maturities of the senior notes are as follows:

	3.00% Senior Notes
Year Ending December 31:	
2017	$ 4,000
2018	4,000
2019	4,000
2020	4,000
2021	4,000
Thereafter through 2032	43,000
	$ 63,000

6. Employee Benefit Plans

Defined Contribution Plan

ERCOT sponsors the ERCOT Defined Contribution 401(k) Savings 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)

6. Employee Benefit Plans (continued)

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

	2016	2015
75% of the employee's contribution up to 6%	$ 3,028	$ 2,879
10% of the employee's compensation	7,474	7,356
Total employer contributions	$ 10,502	$ 10,235

Health Insurance Reserve

ERCOT provides a self-insured group health plan to its employees and pays for all health claims. Incurred-but-not-reported claims liability is accrued. At December 31, 2016 and 2015, the liability is $768 and $924, respectively.

7. Lease and Contract Commitments

The Company has non-cancelable operating leases and service contracts for telecommunication services, system infrastructure, and office facilities. ERCOT currently leases approximately 30,000 square feet of office space in Austin, Texas through March 31, 2022.

(Dollars in Thousands)

7. Lease and Contract Commitments (continued)

Minimum payments due under these commitments are as follows:

2017	$	447
2018		453
2019		441
2020		431
2021		421
Thereafter		106
Total minimum lease payments	$	2,299

ERCOT recognized $670 and $602 of office rent expense in 2016 and 2015, respectively.

8. 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 is 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.

9. 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 of $353,534 were placed in-service date as of December 1, 2010.

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. TNMIP rates were discontinued on January 2, 2013 after ERCOT achieved full recovery of the TNMIP recoverable costs. TNMIP development costs related to the systems under development were capitalized as discussed in Note 2. All other TNMIP development costs were subject to the provisions of regulatory accounting, which provides for deferral of the income statement impact.

(Dollars in Thousands)

9. Accounting for the Effects of Regulation (continued)

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

	2016	2015
TNMIP depreciation and expense not previously captured	$ -	$ 33,526
Amortization of regulatory liability	-	33,526
Regulatory liability, beginning of year	-	(33,526)
Regulatory liability, end of year	$ -	$ -

This regulatory liability was fully amortized on June 30, 2015.

10. 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 flows.

11. Subsequent Events

ERCOT has evaluated material subsequent events through April 5th, 2017, the date the Company's financial statements were available to be issued.