



**Date:** April 10, 2007  
**To:** Board of Directors  
**From:** Steve Byone, Vice President and Chief Financial Officer  
**Subject:** Authority for Additional Debt Financing

**Issue for the ERCOT Board of Directors**

**ERCOT Board of Director Meeting Date:** April 18, 2007

**Agenda Item No.:** 10a

**Issue:**

The Electric Reliability Council of Texas, Inc. (ERCOT) requires authorization from the ERCOT Board of Directors (the Board) to negotiate and execute the documents necessary to (a) obtain financing of up to \$300 million, and (b) enter into interest rate derivative products of up to \$100 million.

ERCOT currently has a Term Loan, with an outstanding balance of approximately \$25,000,000, and a Revolving Credit Facility (Revolver), with an authorized amount of \$125,000,000, to meet its liquidity needs. The Revolver is not expected to be adequate to accommodate ERCOT's financing needs through the next two years.

The requested financing will be in addition to the 2002 Senior Notes, which have an outstanding balance of approximately \$110,000,000, and any TCR borrowings. This requested financing will replace or amend existing revolving and term facilities and provide additional borrowing capacity to fund (a) costs related to the Nodal Program which are not funded with the Nodal Surcharge, (b) capital expenditures from base operations not funded with the System Administration Fee, and (c) working capital needs, on market terms and interest rates.

The authorization and resolution requested herein is intended to authorize total ERCOT debt financing of \$410,000,000, which includes the 2002 Senior Notes and excludes any TCR borrowing.

**Background/History:**

In 2005, ERCOT was charged with implementing a multi-year effort undertaken by the Public Utility Commission of Texas (PUCT) and ERCOT stakeholders to re-design the Texas Electric Market. The estimated cost of the Texas Nodal Market Implementation Program (Nodal Program) is currently \$248.9 million, including interest costs. ERCOT is currently collecting \$0.0663 per MWh under an interim Nodal Surcharge approved by the PUCT for implementation on an interim basis effective October 1, 2006. Based on the current estimated cost of \$248.9 million, ERCOT has filed for a permanent Nodal Surcharge of \$0.127 to be effective June 1, 2007. If approved, ERCOT estimates that this fee will fund approximately 32% of Nodal Program costs through the development period. The remaining 68% of Nodal Program costs is to be financed with debt. To date, the debt which has been incurred by ERCOT to finance Nodal Program costs has been financed under existing credit facilities.

As ERCOT evaluated its financing needs in the Fall of 2006, it issued an RFP for Debt Financing to



fund Nodal Program costs as well as the debt portion of capital expenditures from base operations. The RFP was sent to five financial institutions: 2 banks, 2 Private Placement sources and National Cooperative Services Corporation (NCSC). As ERCOT considered the financing options below, it considered the most cost effective options from the RFP responses.

At December 31, 2006, ERCOT had short term borrowings (excluding Senior Notes and the Term Loan) of \$47 million under the Revolver. By December 31, 2007, ERCOT expects outstanding debt under the Revolver or new facilities to be approximately \$165 million (assuming no TCR borrowings and excluding the current \$25 million Term Loan) and by December 31, 2008, ERCOT expects outstanding debt under the Revolver and/or new facilities to be approximately \$195 million. This is based on estimated debt funding of Nodal Program costs of approximately \$109 million and debt funding of capital expenditures from base operations of approximately \$39 million in 2007 and 2008. In addition, ERCOT is required per the Financial Standard to maintain a base level of availability under facilities to meet liquidity needs. Through 2008, this is expected to be up to an additional \$40 million.

Finally, the Financial Standard requires that “in no event will ERCOT allow un-hedged, variable rate debt to be more than 40% of total debt outstanding”. This requirement mandates that a portion of the new debt issued (ERCOT proposes at least \$100 million) must be fixed rate debt.

ERCOT staff considered two primary financing strategies based on the results from the RFP:

Option 1 - Expanded or new bank facility with an interest rate swap

- Likely incorporate another bank to broaden access to bank market
- Total bank debt at \$275 to \$300 million
  - \$200 - \$225 million Term Loan
    - Includes refinancing existing \$25 million Term Loan
    - Annual pay down through November, 2012
    - Allow for prepayments without penalty
  - \$75 million Revolver
    - Reduce from \$125 million
    - Extend from current maturity in 2010 through 2012
- \$100 million in interest rate swap(s)
  - To be executed through bidding process
  - Fairness opinion obtained
  - Will have income statement and balance sheet implications through 2012 with possible variability up to \$5,000,000 or more

Option 2 – Private placement

- Up to \$175 million of Senior Notes under terms similar to existing Senior Notes
  - Fund \$60-80 million at close and remainder as delayed draw by March 2008
  - Fixed annual pay down schedule to approximate expected revenues at slight discount
- \$25 million Term Loan – retain and payout



- \$75 to \$100 million Revolver
  - Reduce from \$125 million after final funding under new Senior Notes

Comparison of Alternatives

|                                     | <u>Bank Debt w/ Swaps</u>   | <u>Private Placement</u>            |
|-------------------------------------|---|-------------------------------------|
| Pricing                             | <b>Comparable</b>   | <b>Comparable</b>                   |
| Flexibility of terms                | <b>More flexible</b>  | Less flexible                       |
| Flexibility in obtaining amendments | <b>More flexible / more timely</b>  | Less flexible / more formal process |
| Prepayment penalty                  | <b>No</b>   | Yes                                 |
| Ease of execution                   | <b>Easier</b>   | Harder                              |
| Fix rate debt                       | Must execute interest rate swaps to "fix" the debt rate.  | <b>Straightforward</b>              |
| FAS 133 accounting valuations       | Yes, must use FAS 133 accounting. May have valuation swings of \$3 - \$5 million over life of debt. | <b>No</b>                           |

Recommendation

ERCOT staff believes that Option 1 provides the most flexibility both near and long term. However, ERCOT believes that both financing options will meet ERCOT's needs and sought input from F&A as to their financing preference, given the relative merits of each option.

**Key Factors Influencing Issue:**

- Need to fund Nodal Program costs not funded with the Nodal Surcharge
- Need to fund capital expenditures from base operations not funded with the System Administration Fee
- Need for additional financing to fund timing imbalances between cash income and expenses (working capital)

**Alternatives:**

- Increase Nodal Surcharge to fully fund Nodal Program on a pay-as-you-go basis



- Increase System Administration Fee to fully fund capital expenditures on a pay-as-you-go basis
- Increase System Administrative Fee to build cash reserves sufficient to fund imbalances between cash income and expenses and fund Interest Reserve.
- Cut capital projects or other budgetary items
- Execute Private Placement or other alternate strategy
- Execute expanded or new bank facility with interest rate swap

**Conclusion/Recommendation:**

ERCOT staff recommends that the BOD authorize ERCOT to negotiate and execute the documents necessary to (a) obtain financing of up to \$300 million and (b) enter into interest rate derivative products of up to \$100,000,000. The requested financing will replace or amend existing revolving and term facilities and provide additional borrowing capacity to fund (a) costs related to the Nodal Program which are not funded with the Nodal Surcharge, (b) capital expenditures from base operations not funded with the System Administration Fee, and (c) working capital needs, on market terms and interest rates.



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

WHEREAS, the board of directors (Board) of Electric Reliability Council of Texas, Inc. (ERCOT) deems it desirable and in the best interest of ERCOT to negotiate and enter into a new advancing Term Loan Facility with banks for up to \$225,000,000 in principal amount, with a term of up to five and one-half years, to be repaid in annual installments, at market terms and rates (Term Loan);

WHEREAS, the ERCOT Board deems it desirable and in the best interest of ERCOT, to negotiate and enter into a Revolving Credit Facility with banks for up to \$75,000,000 in principal amount, with a term of up to five and one-half years, at market terms and rates, for liquidity purposes (Revolver);

WHEREAS, the Term Loan and Revolver would pay and replace the term loan and revolver credit facilities that ERCOT currently has in place;

WHEREAS, the ERCOT Board deems it desirable and in the best interest of ERCOT to obtain fixed rate interest on up to \$100,000,000 of the floating rate \$225,00,000 Term Loan authorized herein;

And WHEREAS the ERCOT Board deems it desirable and in the best interest of ERCOT to negotiate and enter into interest rate derivative products (Interest Rate Agreements) with swap provider(s) for up to \$100,000,000;

THEREFORE, be it RESOLVED that:

1. The Term Loan, Revolver and Interest Rate Agreements described above are hereby authorized and approved in each and every respect;
2. ERCOT may enter into the Term Loan, Revolver and Interest Rate Agreements and that the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, and General Counsel/Corporate Secretary of ERCOT (Authorized Officers) are each hereby severally authorized to execute and deliver, in the name and on behalf of ERCOT, loan and other documentation evidencing and governing the Term Loan, Revolver or Interest Rate Agreements, including without limitation, a commitment letter, fee letter, credit agreement(s), all related promissory notes, all other related loan documentation and all interest rate hedging, swap or other related interest rate derivative documentation, all substantially in form and substance as shall be approved by the officer executing and delivering the same, such approval to be evidenced conclusively by such execution and delivery;



3. The obligations incurred upon such execution and delivery by ERCOT of the loan documentation evidencing and governing the Term Loan and Revolver shall be in all respects binding and enforceable obligations of ERCOT;
4. The obligations incurred upon such execution and delivery by ERCOT of the interest rate hedging, swap or other interest rate derivative documentation evidencing and governing the Interest Rate Agreements shall be in all respects binding and enforceable obligations of ERCOT;
5. The ERCOT Board severally designates, authorizes, and empowers each of the Authorized Officers (acting together or individually) to perform or cause to be performed, in the name of ERCOT, all acts and deeds, to pay or cause to be paid, on behalf of ERCOT, all related costs and expenses and to make, execute, and deliver, or cause to be executed and delivered, all such other agreements, consents, approvals, orders, applications, requests, demands, directions, certificates, undertakings, supplements, instruments, documents, further assurances, or other communications of any kind, with or without the corporate seal of ERCOT or otherwise, on behalf of ERCOT or otherwise as he or she may deem necessary, appropriate, or advisable to comply with the intent of the foregoing resolutions or to comply with the requirements of the instruments approved and authorized by the foregoing resolutions, including but not limited to, the loan and other documents evidencing and governing the Term Loan, Revolver or Interest Rate Agreements, and any other certificate, instrument, or document related thereto;
6. All acts and things whether heretofore or hereafter done or performed by any Authorized Officer of ERCOT which are in conformity with the intent and purposes of these resolutions shall be and the same are hereby in all respects ratified, confirmed, and approved, and adopted as acts by ERCOT; and
7. The Secretary of ERCOT is hereby authorized and empowered to certify to the passage of the foregoing resolutions with or without the seal of ERCOT or otherwise.