



MEMO

Date: November 9, 2004
To: Board of Directors
From: Ray Giuliani
Subject: Auction Day Ahead Market Timeline

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: November 16, 2004

Agenda Item No.: 5a

Issue:

ERCOT Staff requests that the Board direct ERCOT Staff regarding implementation of an Auction Day Ahead Market prior to possible implementation of Texas Nodal.

Background/History:

PUCT Subst. R. 25.501 requires ERCOT to implement a voluntary day-ahead energy market by October 2006 as part of the implementation of a revised wholesale market design. As part of the Texas Nodal Team (TNT) process, TNT recommended that a day-ahead market would be beneficial even prior to the implementation of a new wholesale market design. At the March 16, 2004 Board meeting, the Board approved the following resolution:

A day-ahead market shall be established in ERCOT through the implementation of the Auction Day-Ahead model by March 2005 or as soon as practicable and the implementation of a day-ahead market that includes the settlement of CRRs in both real-time and day-ahead timeframes, and is substantially similar to the currently proposed Enhanced Hybrid Day-Ahead model within 12 months or as soon as practicable following the implementation of the real-time nodal market.

Thus, the Board has directed a possible two-step implementation of the day-ahead market – starting with the less complex auction model and later moving to the more sophisticated EHDAM that incorporates congestion management elements within following implementation of Texas Nodal.

Some participants in the TNT process have wavered on an earlier implementation of the ADAM due in part to the comments received from the four economists evaluating the Texas Nodal design elements. The economists all focused on the value of the greater integration of the day-ahead market and real time market operation provided by EHDAM - and their



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preference not to devote resources to developing an ADAM as currently prescribed by TNT.

In keeping with the Board's direction, ERCOT has worked with stakeholders to pursue options to implement an auction day-ahead market. After review of ERCOT's estimate for an internal implementation project, WMS recommended that a third party develop the ADAM credit and auction engines. TAC approved the development and issuance of an RFP and worked with ERCOT Staff to establish an Evaluation Team that included PUCT, Market Participants from all Segments, and ERCOT Staff.

On July 28, 2004, ERCOT Staff issued an RFP for the ADAM. Seventeen vendors submitted a Notice of Intent to Bid on the RFP. ERCOT Staff received four vendor proposals in response to the RFP. ERCOT established an Evaluation Team made up market participant representatives throughout the market that developed the criteria and weighting used to identify the two short-listed vendors. The Evaluation Team recommended one vendor by a simple majority (4.5 to 3.5).

Details of the vendor bids and the evaluation scoring are provided to the Board separately under confidentiality protection for possible discussion in executive session, if needed.

Key Factors Influencing Issue:

- The costs to implement an Auction Day Ahead Market are high (internal and vendor proposals) ranged from \$2 million to \$10 million.
- In light of the range of estimated costs and the recent comments economists in the TNT process, there is little consensus among Market Participants of the benefits of implementing an auction Day ahead market as currently contemplated.

Alternatives:

ERCOT Staff suggests the following options for Board action:

1. Rescind the previous directive to implement ADAM prior to Texas Nodal implementation.
2. Proceed with the third party implementation of ADAM as currently proposed by the successful bidder.
3. Develop new alternatives for implementation (possibly using a new RFP process) and proceed with an internal or third party implementation of ADAM via qualified vendor(s) for a minimum term of 5 years subject to some limitations -
 - (a) implementation costs not to exceed \$2 million,
 - (b) reasonable transaction fees, and
 - (c) no annual operation costs.



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Conclusion/Recommendation:

ERCOT Staff believes that an auction day-ahead market would benefit the ERCOT Region, however, costs must be controlled. ERCOT Staff recommends that ERCOT should continue to explore the possibility of an internal or external implementation of ADAM as described in Option 3 above. If ERCOT cannot implement an ADAM in accordance with the cost limitations set forth above and with qualified vendor(s), ERCOT should not implement an ADAM at this time and should report back to the Board accordingly by the February 2005 Board meeting.