MEMO

Date: March 8, 2005
To: Board of Directors
From: Read Comstock, TAC Chair
Subject: Heat Rate Adder for Unit Specific Generic Costs

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: March 15, 2005
Agenda Item No.: 10b

Issue:
Establishing the heat rate adder to be used in the calculation of Resource-specific bid premiums for Balancing Energy Service used as part of the calculation of payment for relieving Local Congestion.

Background/History:
To resolve Local Congestion, ERCOT must instruct particular Resources to alter their energy output (or consumption in the case of Loads acting as a Resource – LaaRS). The payment calculation for a Resource's response to these instructions is established by: (1) established Generic Costs of the Resources and (2) the Resource Entity's pricing of the Resource's service reflected in "bid premiums" included in Balancing Energy Service bids for that Resource.

PRR 485, *Revision to Unit-Specific Deployment Based on Generic Cost* (approved by the Board on April 4, 2004), revised the Protocols such that Resource-specific bid premiums for Balancing Energy Service must have limits based on a generic category cost. Revised Section 4.4.20 (*Publication of Resource Category Bid Limits*) contains boxed language (to be implemented with Energy and Market Management System (EMMS) Release 4) that requires that ERCOT calculate and publish the Resource Category Generic bid limits for Balancing Energy Up and Balancing Energy Down for each Resource Category for each

[1] The Resource Category Generic bid limits for Balancing Energy Up for all gas-fired Resources will be calculated by multiplying the most recent FIP by the sum of a constant heat rate adder and the Resource Category heat rate. The Resource Category Generic bid limits for Balancing Energy Down for all gas-fired Resource are to be calculated by multiplying the most recent FIP by the difference of a constant heat rate adder and the Resource Category heat rate. Finally, for all other Resource Categories, the Resource Category Generic bid limit for Balancing Energy Up and the Resource Category Generic bid limit for Balancing Energy Down will be calculated using the appropriate Resource Category Generic Fuel Cost calculation using the most recent FIP (if needed in the calculation as set forth in Protocols Section 6.8.2, *Capacity and Energy Payments for Out-of-Merit or Zonal OOME Service*).

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day for which the Fuel Index Price ("FIP") is published.[1]

Board action required. PRR 485 directs that the proposed value of the heat rate adder must be recommended by the appropriate TAC subcommittee and approved by the Board of Directors. The value will be re-evaluated on a quarterly basis. The heat rate adder function will be part of the ERCOT EMMS Release 4 and, therefore, must be approved before Release 4 can be implemented (currently scheduled for June, 2005).

Key Factors Influencing Issue:

On February 18th, WMS considered the issue of the heat rate adder and, after extensive discussion, voted to recommend a heat rate adder value for Balancing Energy Up of one (1) and a heat rate adder for Balancing Energy Down value of one (1). TAC reviewed the WMS recommendation on March 3, 2005.

TAC considered a number of motions on this issue. The first motion -- to recommend a heat rate adder value of one (1) for Balancing Energy Up Service, and a heat rate adder of negative (-1) for BE Down Service -- failed based on a vote of 18 in favor, 8 opposed and 3 abstentions. The next motion -- to pass the WMS recommendation -- failed based on a vote of 8 in favor, 18 opposed and 3 abstentions. A motion to approve a heat rate adder of one (1) for BE Up Service and a heat rate adder of zero (0) for BE Down Service failed by a vote of 5 in favor, 7 opposed and 16 abstentions.

The last motion was to recommend that the value of the heat rate adder be set at zero (0) for both Balancing Energy Up and Down. The TAC vote was 21 in favor, 7 opposed and 1 abstention. The nay votes were from the Independent Generator and Power Marketer Segments. The effect of a zero adder is that the payment for energy would be based on the fuel index price multiplied by the generic heat rate with no increase or decrease in the generic heat rate value.

Alternatives:

(1) Approve the TAC recommendation for a heat rate adder for bid limit calculations as a value of zero (0); or (2) remand the issue back to TAC with instructions.

Conclusion/Recommendation:

TAC recommends the Board approve the TAC recommendation for a heat rate adder of zero (0) for Balancing Energy Up Service and Balancing Energy Down Service.