

MEMORANDUM

TO: Board of Directors

FROM: Mike Grable, ERCOT General Counsel

RE: January 2009 Board Action Item - Transmission Service and Ancillary Service Allocation

Date: January 13, 2009

Pursuant to a request from Dr. Patton, this memorandum identifies the governing framework – specifically, Public Utility Regulatory Act (PURA) and ERCOT Protocol language – regarding the use of a “postage stamp” pricing mechanism for transmission service and for Ancillary Services in the ERCOT Region.

For transmission service, Senate Bill 7 implemented the use of postage stamp pricing for transmission service in the ERCOT Region. Specifically, PURA § 35.004(d) required the Public Utility Commission of Texas (Commission) to price wholesale transmission services within ERCOT based on the “postage stamp” method of pricing (in short, setting a transmission-owning utility's transmission rate based on ERCOT-wide averaged costs and requiring that Load pay for the transmission). Because statutory language is controlling on ERCOT, there is little if any room for the Board to set policy in this area.

PURA § 35.004(e), in turn, governs Ancillary Services and instructs that, after the introduction of customer choice in 2002, ERCOT is responsible for “acquisition of generation-related ancillary services on a nondiscriminatory basis.” Section 6 of the ERCOT Protocols governs Ancillary Services, and Section 6.9 in particular describes the settlement of and payment for Ancillary Service costs. Currently, except for the Balancing Energy Service (where those entities that are short pay the cost of the service) and except for those Ancillary Services that are self-arranged, the bulk of Ancillary Service costs are assigned to Load. These decisions being set by Protocol language, the Board has significantly more discretion in this area than in the transmission-pricing area.

I look forward to discussing these issues with you at the Board meeting.