



NPRR 206

"e" Factors Procedure and Variables

Cheryl Yager
Treasurer
April 20, 2010

Summary

- **NPRR 206 and the related Procedure for Setting DAM Auction Credit Requirement Parameters**
 - Revises credit requirements for the DAM auction
 - “Core” collateral valuations in Section 16 are not impacted
 - Parameters are set conservatively during the first 60 days of the market
 - Seeks to balance the need for greater market liquidity with the need to ensure that DAM activity can be paid for and does not negatively impact a Counter-Party’s (CP) overall financial position in the ERCOT market
 - Generally, the “e” factors:
 - Allow bids to be valued somewhere between recent historical values and full bid price (based on recent DAM activity)
 - ERCOT will monitor for significant changes in awarded bids and offers to identify potentially risky or aggressive behavior and may require collateral for full bid price if needed.

Summary

- Under certain circumstances, allows a level of credit for Energy Only Offers (EOOs). (There was considerable discussion on this point)
 - Reasonable practice for “normal” activity
 - Risk: The potential for under-collateralization exists when current activity is not consistent with historical activity. In a worse case scenario, there is risk that this factor could be manipulated to “create” credit.
 - » Mitigation:
 - » Credit is granted only when CP consistently provides information about activity in advance.
 - » Even when credit is granted, collateral will be held for EOOs at the difference between the DAM and Real Time prices (at the 95th percentile).
 - » ERCOT will monitor for significant changes in awarded bids and offers and will eliminate credit if needed.
 - Note: Three Part Offers (TPOs) also receive credit based on the fact that physical assets back up these offers (no “e” factor customization).

Highlights of Procedure

- **Establishes values for the variables defined in NPRR 206**

(d, a, b, y, z, u, t)

- Variables relate to the percentile of 30-day historical pricing that will be used to value various bids and offers (e.g. 95th percentile of the past 30-day historical pricing would use the 3rd highest price in the past 30 days)

- **Establishes procedure for determining individual “e” factors**

- Tailored to each CP by way of CP’s historical DAM activity
- General treatment – “e” factors set conservatively
- Optional treatment
 - Allows for more favorable “e” factor settings
 - Requirement – CP provides ERCOT advance notice of changes in “e” factors and their components
 - Demonstrates CP’s control over their activity
 - Provides ERCOT with an opportunity to gain an understanding (prior to activity) of what a CP is doing and why
 - If ERCOT believes the level of disclosure is adequate and the risk is acceptable, ERCOT may allow more favorable “e” factor settings

Highlights of Procedure

- **ERCOT retains flexibility to adjust any “e” factor if ERCOT determines that the calculated “e” factor does not adequately match the financial risk created by that CPs activities in the market**
 - May be done immediately, if needed
- **ERCOT will review “e” factors**
 - At least once every two weeks
 - Will update based on recent DAM activity
 - More often as needed
 - When DAM activity warrants (e.g. EOOs suddenly and/or significantly increase or decrease)
 - Due to other credit factors (e.g. changed financial circumstances, etc.)
 - If “e” factors are to be changed
 - Generally with 2 bank business days notice
 - May be done immediately, if needed

Highlights of Procedure

- **ERCOT supports the procedure approved by the market**
 - For effective management of risk, ERCOT will need to monitor for unusual DAM activity and adjust “e” factors when needed
 - When NPRR 206 was considered, ERCOT estimated an ongoing need for .2 FTE to manage this process. With the currently proposed procedure, ERCOT now estimates that it will require up to .5 FTE to manage this process.