DOCKET NO. 24770

2003 APR -3 PM 2:22
PUBLIC UTILITY COMMISSION
FILING CLERK

REPORT OF THE ELECTRIC RELIABILITY COUNCIL OF TEXAS (ERCOT) TO THE PUCT REGARDING IMPLEMENTATION OF THE ERCOT PROTOCOLS	§ § § § §	**PUBLIC UTILITY COMMISSION** **OF TEXAS**

OFFICE OF PUBLIC UTILITY COUNSEL'S AMENDED COMMENTS

TO THE HONORABLE COMMISSION:

COMES NOW, the Office of Public Utility Counsel ("OPC") to amend OPC's comments filed earlier to read as follows:

I.

OPC offers the following comments on bid/offer caps for ancillary services and the Modified Competitive Solution Method (MCSM) for balancing energy service.

OPC supports the continued implementation of price caps and the execution of the MCSM as proposed by staff. We request the Commission adopt these mitigation tools proposed by staff as soon as possible. Both proposals serve to protect customers and load serving entities from excessive prices in the ancillary services markets. Excessive prices can result from factors such as gaming, exercise of market power, demand inelasticity, unexpected shortages, and combinations thereof. Any of these factors that take prices far in excess of marginal cost call into question the efficiency of the market. Further, the staff proposal achieves its aims without endangering generation adequacy or eliminating incentives to the real time market.

It is important that the Commission enact the measures proposed by staff as soon as possible. It is likely the summer months will create additional scenarios for price

197

spikes similar to those seen in February. Many legislators have expressed concern to OPC regarding the prices for ancillary services that were realized February 24-27. Finally continued price volatility will hamper the development of the ERCOT market by making it difficult for LSEs to know their costs or making it more costly to hedge against volatility.

Certainly, some players in the market stand to gain from price volatility and those parties will oppose MCSM and price caps. However, their gain will be at the expense of overall market efficiency and added cost to loads at a time when confidence in the newly formed market is essential.

Modified Competitive Solution Method (MCSM)

This proposal is geared to fix a strategy termed "hockey stick bidding". Staff observed this behavior in February and in at least one other circumstance. This bidding behavior was also observed in California. Staff makes a very compelling case for the implementation of MCSM in its Report dated March 3, 2003 and the Memorandum filed March 18.[1] The report observed that a peaking unit would have fuel costs of $250 per MWh, yet the UBES service cleared at $990 per MWh. The price of $990 was set by a bid for a single MWh. All other quantities bid in that hour were at $200 or lower. The additional cost of the last hour of UBES was estimated at $17 million for the price spikes of February 24-25.[2]

More information is needed to know, with certainty if the $990 bid was necessitated by cost. However, a generator needing a price of $990 is hard to fathom. It

---

[1] Analysis of Balancing Energy Price Spikes During the Extreme Weather Event of February 24-26, March 3, 2003. "Proposal to Apply a Modified Competitive Solution Method to Balancing Energy Service and Update on Applying the Competitive Method to Ancillary Capacity Services", March 18, 2003.

is for certain that a bid for a single MWh set the price for all UBES service for the associated time period. Consequently, many other generators benefited from a bid for one MWh, at a cost to load of an additional $17 million.

Without some way to address the incentives to pursue "hockey stick" bidding, it is readily assumable that some market participants will follow a "hockey stick" bidding strategy. The potential gain is significant and does not violate any market rule. The "hockey stick" strategy will result in gain to the generator and added cost to load that leads to inefficiency in the market. The inefficiency occurs because a player has the ability to be a price maker in a situation when the upside is large and the downside is small. The downside is small because the player risks a minimal bid (say 1MWh) to set a high market clearing price for all bids – the large upside.

OPC supports MCSM but would like to see the Commission simultaneously move toward the full Competitive Solution Method proposed by Staff. It is our understanding that MCSM is being proposed because it can be implemented in a shorter time frame. OPC urges the Commission to continue to pursue CSM as it is seen as a more effective solution to the problem because it also addresses the issue of pivotal bids.

Price Caps

In addition to the protection offered by MCSM for strategic bidding behavior (such as "hockey stick bidding") that is observed, our market also needs protection against strategies that have not yet been observed or foreseen. This is where price caps come in. Price caps offer protection against a surge in prices resulting from some

[2] Analysis of Balancing Energy Price Spikes During the Extreme Weather Event of February 24-26, March 3, 2003. p. 2.

unexpected strategy. Price caps offer protection to the market until a protocol or other action can be taken. Therefore it is imperative that the Commission adopt both MCSM and price caps as tools to protect consumers and load serving entities in the retail market.

II.

As for comments on the procedural schedule, OPC has no specific requests; however OPC is requesting that there be no deadlines or testimony required for the month of July and the first week in August. This is because our expert will be overseas during that time period.

Prepared by: Kenan Ögelman

April 3, 2003

Respectfully submitted,

Suzi Ray McClellan
Public Counsel
State Bar No. 16607620

Lanetta Cooper
Assistant Public Counsel
State Bar No. 04780660

OFFICE OF PUBLIC UTILITY COUNSEL
1701 N. Congress Avenue, Suite 9-180
P.O. Box 12397
Austin, Texas 78711-2397
512/936-7500 (Telephone)
512/936-7520 (Facsimile)