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

**COMMENTS AND RECOMMENDATIONS**
**OF CITY PUBLIC SERVICE OF SAN ANTONIO**

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

City Public Service of San Antonio ("San Antonio") submits these comments and recommendations in response to Order No. 18 (March 24, 2003) (*Establishing Deadline for Comments*) in this docket. Specifically, Order No. 18 invited parties to submit comments and recommendations regarding:

- Staff memo dated March 17, 2003, relating to bid/offer caps for ancillary services; and
- Staff memo dated March 18, 2003, relating to a proposal to apply a modified competitive solution method to balancing energy service.

## I. Staff Memo Dated March 17, 2003

In its March 17, 2003 memo filed in this docket, the Staff recommends that various offer caps approved by the Commission be continued beyond July 4, 2003. Offer caps for balancing energy were originally established by the Commission in Docket No. 23220, with different caps applying to generation and load resources. In Order No. 14 at 1 (Aug. 23, 2003), a Commission administrative law judge approved on an immediate and interim basis offer caps of $1,000/MWh for energy $1,000/MW per hour for capacity, with no distinction between generation and load resources.



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San Antonio is not opposed to the continuation beyond July 4, 2003 of the interim energy and capacity offer caps established in this docket.

## II. Staff Memo Dated March 18, 2003

The Staff's March 18, 2003 memo proposes what it labels as a Modified Competitive Solution Method ("Modified CSM") for Balancing Energy Services. The Staff's original proposed Competitive Solution Method ("Original CSM") is, as defined, only applicable to the day-ahead ancillary service capacity markets. Numerous comments and concerns have already been submitted by San Antonio and other parties in this docket regarding the Original CSM, and will not be repeated here. The Modified CSM, as presented in the Staff's March 18, 2003 memo, represents the first publicized attempt by staff to apply the "CSM" to the Balancing Energy markets. It should be noted that, while the Original CSM and the proposed Modified CSM share a similar component of their names, the mechanisms and the markets to which they apply are distinctly different. For example, the Original CSM is intended to apply to the day-ahead ancillary service capacity markets, which are ERCOT-wide day-ahead products. In contrast, the Modified CSM is intended to apply to balancing energy, which is a zonal real-time product, and the deployments in each zone are not independent and should not be viewed in that manner.

Further, while labeled a Modified CSM, the proposed methodology in fact does not represent an attempt to produce the results of a competitive solution at all. What the Modified CSM does represent is simply a method to re-price the zonal market clearing prices for energy ("MCPEs") when one condition is met, that is, when all of the eligible Up Balancing Energy Service ("UBES") or Down Balancing Energy Service ("DBES") bids in a zone are deployed. This re-pricing would occur regardless of whether a "competitive solution" exists. Thus, the Modified CSM is really a proposed "hockey stick" bid mitigation mechanism for balancing energy, which has the possibility of being triggered in the presence of hockey stick bids or under other circumstances.

While hockey stick bids are neither prohibited nor defined under the current ERCOT Protocols, the effects of such bidding behavior are clearly apparent from the market results during the last week of February 2003, and San Antonio understands and appreciates the Commission's concern regarding the market impacts of these results. In Docket No. 23220, the Commission posed the question "What self-implementing mechanisms should be added to the Protocols to avoid extreme price spikes?" In its initial brief in that docket, San Antonio provided the following response to this question:[1]

> As the Commission considers alternatives related to this issue, CPS believes that it is important to bear in mind that price fluctuations—some of which may be characterized as "extreme"—are an expected and necessary component of competitive markets, and that great caution should be applied in the application of mechanisms that would serve to dampen or eliminate the price signals that are created by the normal interactions of market supply and demand. However, CPS does recognize that the market mechanisms being created are new and untested in ERCOT, which could lead to results at times that are not indicative of the "normal" supply/demand interaction.
>
> One such mechanism, which was reflected in the ERCOT Protocols as approved by the ERCOT Retail User's Group (RUG) and the ERCOT Technical Advisory Committee (TAC), but which was mysteriously removed, would have limited the deployment of energy from the balancing energy (BE) stack at 95% of the total MW in the BE stack. In other words, the BE stack would be truncated at 95% of the total MW, such that the highest 5% bids (in MW) were removed from consideration and unavailable for use by ERCOT.

[1] *Petition of the Electric Reliability Council of Texas for Approval of the ERCOT Protocols*, Docket No. 23220, San Antonio City Public Service's Initial Brief at 6-7 (Jan. 26, 2001) (footnotes omitted).

> An alternative (but similar) mechanism may also be worthy of consideration. Instead of truncating the BE stack at a specific MW threshold (e.g., 95%, or another threshold as determined appropriate), the payment mechanism could be adjusted such that an MCPE is applied for all bids at or below the threshold, and bids above the threshold are paid-as-bid. This alternative has the benefits of (1) maintaining the availability of energy for use by ERCOT for bids that are greater than the threshold; (2) mitigating the impact of outlier bids on the MCPE, and (3) ensuring payment to providers for services rendered, while at the same time providing increased visibility and accountability for bids above the threshold. However, one downside to this approach relates to its complexity, in that multiple resource prices are introduced when the balancing energy requirements exceed the threshold, which may create some difficulty in integrating this approach into a system design that revolves around the existence of a single price for balancing energy in each zone for each settlement interval.

The Commission did not adopt San Antonio's recommendations on this issue in Docket No. 23220. At this time, San Antonio resubmits for consideration its alternative mechanism, as described above, as an approach that better achieves the objectives of the Modified CSM through a balanced approach that addresses the concerns associated with the potential impact of outlier balancing energy bids while not significantly distorting the economic outcomes of the market.

The Modified CSM is triggered only when the entirety of a zonal BES stack has been exhausted, which may cause the "problems" that are intended to be addressed to persist if, for example, 98 percent of the zonal BES stack were deployed. In contrast, San Antonio's alternative mechanism would be triggered when 95% of a zonal BES stack was deployed. If only a small quantity of bids were priced very high at the upper end of the BES stack, the hockey stick phenomenon would be effectively mitigated and reflected in the resulting zonal MCPE. However, if many bids were similarly priced a the upper end of the BES stack, this would be more indicative of true scarcity than of hockey stick bidding strategies, and while the MCPE would be mitigated under San Antonio's alternative mechanism, the resulting mitigated zonal MCPE would not be substantially different than the unmitigated zonal MCPE.

Another key difference between the Modified CSM and San Antonio's alternative mechanism is the treatment of bids above the threshold (90 percent under the Modified CSM; 95 percent under San Antonio's proposed alternative mechanism). Under the Modified CSM, these bids would be eligible to be paid at "verifiable costs." It is unclear what would be included as verifiable costs (*e.g.*, would this include opportunity costs, risk factors, etc?). Further, with no analysis, this approach presumes that these bids are inappropriate, and automatically changes the payment for the services provided through an administratively burdensome process. In contrast, San Antonio's alternative mechanism would provide for payment for these above-threshold bids on an "as-bid" basis, thereby effectively mitigating potential extreme effects on the zonal MCPE while also providing payment for the services furnished by market participants at the prices that were offered. At a minimum, if the proposed Modified CSM is adopted, San Antonio suggests that bids above the threshold be paid "as bid," as opposed to being based upon the undefined and administratively burdensome "verifiable costs" approach.

As indicated in its initial brief in Docket No. 23220, implementation of San Antonio's alternative mechanism would require certain changes to the ERCOT settlement process to ensure revenue neutrality to ERCOT and proper assignment of the costs incurred by ERCOT in the presence of "as bid" payments when the 95 percent threshold is surpassed. While not indicated in the Staff's March 18th memo, such changes would also be necessary under the Staff's Modified CSM approach due to the proposed payment of certain bids at "verifiable cost" rather than the zonal MCPE.

Respectfully Submitted,

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