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DOCKET NO. 24770

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

RESPONSE OF THE AEP ERCOT COMPANIES TO ORDER NO. 18.

NOW COME the power generation companies of AEP Texas North Company and AEP Texas Central Company (hereinafter referred to jointly as the "AEP ERCOT Companies") and file the following comments regarding the following Staff proposals:

- 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 (MCSM) to balancing energy service.

On March 17, 2003 Commission Staff filed a memo seeking a "Commission ruling to eliminate the July 4, 2003 generator balancing energy bid cap termination date as part of the final order in Docket No. 24770, and requesting that a termination date not be placed on the other bid caps that Commission has approved on an interim basis in this docket." Staff also noted that, "under this recommendation, the Commission will have an opportunity to revisit the level of the bid caps as part of the planning reserve rulemaking, Project No. 24255."

The AEP ERCOT Companies disagreed with the need for establishing the bid cap in Docket 23220 and similarly does not believe that there is a need to extend these caps beyond the existing termination date. However, should the Commission decide to continue imposing such caps, a review of the assumptions used as the basis for the established cap should be conducted to ensure that the level of the cap meets with the original intent.

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Order Number 7 in Docket 23220 states that, "the bid caps were calculated based on the cost of a new simple cycle gas turbine and a high gas cost."[1] Specifically, the current cap is based on "fixed annual cost of $70,000/megawatt (MW)-year divided by 75 hours/year of operation plus a 12,000 heat rate multiplied by a $8/million British Thermal Units (mmBtu) gas price."

Under current market conditions the current level of $1,000/MWH bid cap maybe too low. Given that the gas prices experienced during the recent cold fronts are well in excess of the assumed $8.00/mmBTU gas price, it is reasonable to conclude that the cap should be increased to reflect the higher gas prices than can be experienced during such events.

In addition, the existing bid cap assumes that prices reaching these levels for as many as 75 hours would be consistent with the cost recovery necessary to support a simple cycle combustion turbine (CT) in the market. Yet the ERCOT market clearing prices have not attained this level for anywhere near this number of hours, indicating the prices being experienced are too low to recover assumed fixed costs. This review also indicates that the prices being experienced in the market are insufficient to maintain the operation of units that may be needed during emergencies. Imposing unnecessary price mitigation measures at this time could further reduce the likelihood that the cost of operation will be recovered, and may lead to units being retired or mothballed, making them unavailable for dispatch at any price.

Regarding MOD's memo seeking the implementation of a modified version of the Competitive Solution Method (CSM), the AEP ERCOT Companies do not agree that it is necessary to implement such a price mitigation strategy. Like the implementation of the CSM the implementation of MCSM will result in not only mitigating inappropriate bids, but also appropriate and reasonable bids. MOD's proposal seems to suggest that this additional mitigation is necessary in response to the few hours of recent price spikes experienced in the market. Prior to implementing such a change it is appropriate to review (1) the existing bid cap to determine if the prices being experienced are inconsistent with its assumptions and (2) the impact on the ERCOT market, market participants and market operations.

[1] Docket 23220, Order #7, page 13

MOD states that the proposed MCSM will have little impact on the ERCOT *systems*. While this point may be true, the AEP ERCOT Companies believe it may have an unintended impact on the ERCOT market and operations. It is possible, if not likely, that a situation could present itself again where ERCOT is capacity short and therefore ERCOT is deploying balancing up service across all zones leading to high prices in all zones. If at the same time congestion is occurring on a specific commercially significant constraint (CSC), ERCOT will then begin to adjust balancing up deployments between the CSC zones to relieve the congested constraint. If during the course of clearing congestion ERCOT exhausts the upward bid stack in one of zones, MOD's proposed MCSM would be triggered. The proposal would then significantly reduce the price for balancing energy in the exhausted zone. If this zone happens to straddle the congested CSC, the reduction in MPCE will result in a reduce shadow price and in some cases a negative shadow price if the MPCE in the exhausted zone would be less than MCPE of the other zone that straddles the CSC. Given the prevailing high prices across all zones, the MOD proposal would likely reduce them below the price being paid in other zones where the bid stacks have not been exhausted. Take for example:

1. Assume a two-zone system, A & B with unity shift factors and a transfer limit (A to B) of 1200 MW.
2. Assume Zone A has balancing up bids of 1300 MW at $500/MWh.
3. Assume Zone B has balancing up bids of 900 MW at $400/MWH and 100 MW at $800/MWH.
4. Assume zonal schedules are otherwise balanced so that the QSE scheduled generation and load in each zone is perfectly balanced and there is no use of the CSCs.
5. Assume the schedules are 2200 MW under the actual load and all of the shortage is in Zone B.
6. If ERCOT simply deploys balancing energy, without recognizing the constraint ERCOT would deploy 1300 MW from Zone A and 900 MW from Zone B. However, this would violate the 1200 MW transfer limit since it would cause a transfer of 1300 MW over the lines limited to 1200 MW.

7. Instead ERCOT would split the bid stacks and only deploy 1200 MW from Zone A setting a clearing price in Zone A of $500/MWH. ERCOT would also deploy 1000 MW from Zone B and, absent MCSM, set a clearing price of $800/MWH. However, since a 1000 MW deployment would exhaust the Zone B stack the Staff's MCSM would reset the clearing price down to what it would have been if only 90% of the stack were cleared, or $400/MWH.

Such a pricing situation would further impact the CSC shadow price calculations and result in payments and charges to market participants that are counter to what is needed for ERCOT to operate the system reliably.

For these reasons AEP believes that both the Staff's recommendation to eliminate the expiration date on the $1,000/MWH cap and MOD's recommendation that the modified CSM should be implemented should be rejected.

Date: April 3, 2003

Respectfully submitted,

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