DOCKET NO. 24770

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

AMICUS CURIAE COMMENTS ON COMMISSION STAFF PROPOSALS OF COMPETITIVE POWER ADVOCATES

TO THE HONORABLE CHAIRMAN AND COMMISSIONERS OF THE PUBLIC UTILITY COMMISSION:

The Competitive Power Advocates ("CPA")[1] respectfully file these Comments in response to the Commission Staff's proposals in their March 17, 2003 and March 18, 2003 memoranda, in response to Order No. 18. CPA members Constellation Power Source and Tractebel are parties to this proceeding. Neither CPA itself nor the remaining CPA members participating in this filing are formal parties. CPA as an organization submits these comments as amicus curiae, because the issues that Order No. 18 identifies directly and substantially affect the CPA members' interests.

CPA represents numerous independent power producers and wholesale market participants. CPA fully supports the Commission staff's goals of protecting against market power abuse and circumvention of established market rules and ERCOT protocols. Market power abuse impacts not only retail customers, but competitors as well. CPA members, as much as anyone else, suffer when certain market participants abuse the market rules. Markets cannot function in a manner that efficiently allocates scarce resources unless regulators enforce the rules comprising the market and minimize the opportunity to circumvent those rules. CPA supports MOD's goal to free markets of

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[1] Members of CPA participating in these comments include Dynegy, Inc., FPL Energy, Gregory Power Partners, L.P., Mirant Americas Energy Marketing LP, and Tractebel Energy Marketing, Inc.

of anti-competitive market abuses. Yet, CPA also believes that absent emergency conditions or compelling public necessity, regulatory intervention and suppression of natural market forces should occur only after thorough investigation and consideration of empirical data, full opportunity for market participants to evaluate and comment on proposed intervention, and in light of the Legislature's expressed policy, only after findings that competitive solutions cannot work and that the Commission therefore must adopt a regulatory solution. Both issues the Staff raises represent instances where market conditions may warrant ultimate Commission action, but Staff has not yet demonstrated why the Commission should act now rather than continuing to review available empirical data and consult with market participants.

I. RESPONSE ON BID/OFFER CAPS TERMINATION DATE

The Commission should not eliminate the termination date for the bid/offer caps. As the Commission Staff's memo suggests, bid caps should be periodically reviewed to ensure that they do not become too high or too low and thereby adversely affect generation investment and other market decisions.[2] As market conditions change, a bid cap established more than a year ago may no longer match market realities. The Commission has itself forecasted that ERCOT reserve capacity will decline over the next few years, and the Staff has even noted that recent mothballing of certain plants has accelerated this trend. The bid cap termination date acts as a prompt to review the bid caps and determine that they continue to match market needs and conditions, or to determine that they warrant adjustment. In this respect, the bid cap termination date functions much like the state agency sunset provisions—the termination date essentially sets a schedule by which the Commission will review the bid cap. While the Staff's

[2] Staff Memorandum, March 17, 2003, p. 2.

memo suggests that the Commission can review the bid caps in the planning reserve rulemaking, that alternative does not address the periodic termination date issue. Accordingly, the Commission should maintain the current termination date, and plan its consideration of the bid caps' adequacy to occur before the termination date.

The Commission, as part of its bid cap review process, should also note that bid caps should apply only when a fully functioning capacity market exists. The Commission should note in this respect that the Staff's various filings on its competitive solution method have highlighted the FERC's determination that automatic mitigation measures must accompany bid caps. The FERC, however, also determined that a fully functioning capacity market must exist before bid caps will operate properly. The FERC's single market design order noted:

> However, market power mitigation may tend to suppress the scarcity price that would otherwise stimulate new resource development. As a result, investors may not develop adequate infrastructure—making the problem worse—unless there is a provision for resource adequacy.[3]

As such, the Commission should act carefully in establishing bid caps and other market-altering mitigation methods in the absence of a fully developed ERCOT capacity market.

II. RESPONSE ON MODIFIED COMPETITIVE SOLUTION METHOD

While CPA believes that the Staff's Competitive Solution Method ("CSM") or Modified Competitive Solution Method ("MCSM") may ultimately be warranted, CPA supports Austin Energy, Reliant Resources, and other market participants in their recommendation that the Staff and other stakeholders have not sufficiently studied and analyzed these significant proposals to warrant their immediate adoption. In short, the

[3] Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, Notice of Proposed Rulemaking, Docket No. RM01-12-000, July 31, 2002, p. 256.

Staff has not made the case that its static studies of how the CSM or MCSM would have functioned historically predict how the market will operate in the future when parties will react dynamically to the CSM or MCSM requirement. Nor has the case been established that the recent ice storm, or any other event resulting from factors involving more than just market participant behavior, compels immediate action without undertaking the analysis necessary to establish how the MCSM will affect the overall market. Finally, any analysis of how to remedy the perceived faults leading to the bids ERCOT received during the ice storm should examine the other factors that contributed to those events, particularly including ERCOT's actions, including its load forecasting and resource planning.

As a threshold matter, the Commission should refrain from permanently changing wholesale market design based on a reaction to a one-time event. The March 18th memo suggests that the ice storm bidding patterns warrants the MCSM. Yet, the Staff has cautioned that it has not yet finished its analysis of the bidding behavior during the ice storm, noting that "it is too early to conclude that any particular market participant was actually involved in such behavior [market manipulation] during February 24 and 25."[4] MOD staff continues to meet with market participants and review information, and has not even concluded that market manipulation occurred. To the extent that the Staff advances the MCSM as a means to "fix" what occurred during the ice storm, no evidence exists as yet that anything occurred requiring a "fix." That is, no evidence suggests that the $990 bids reflected any untoward or unacceptable behavior warranting regulatory intervention. Imposing the MCSM in such circumstances may reduce bids below $999,

[4] Analysis of Balancing Energy Price Spikes During the Extreme Weather Event of February 24-26, March 3, 2003, p. 1.

but would supercede normal competitive forces without the market power occurrences necessary to justify such intervention.

More importantly, implementing an ad hoc directive to address a one-time event, without fully considering how the change will affect other market dynamics, could lead to adverse unintended consequences and possibly even make similar conditions worse in the future. This consideration suggests that the Commission should consider the MCSM and CSM during a more comprehensive analysis. CPA therefore supports Reliant Resources' suggestion that the Commission should sever this issue into a separate rulemaking, or that it should consider the issue in the ongoing wholesale market design rulemaking, so that it can view the issue against the larger market backdrop.[5]

The Commission also should note that the ice storm bidding almost certainly reflected capacity scarcity, which the MCSM does not address (and which it could aggravate over the long term). ERCOT's own ice storm event analysis noted that gas companies curtailed deliveries to generating facilities, and that a capacity shortage existed due to curtailments and facilities burning oil. ERCOT also noted that it received insufficient balancing energy bids, requiring it to solicit additional bids.[6] If the ice storm serves as the basis to adopt the MCSM without undertaking any further analysis, the Commission should realize that the MCSM would not have addressed the more fundamental capacity problems that ERCOT identified in contributing to the bidding behavior during the storm.

Additionally, in considering how the market design should mitigate against occurrences similar to the ice storm behavior, the Commission must consider how all

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[5] Reliant Resources, Inc.'s Response to Staff Proposal of March 18, 2003, pp. 1-2.
[6] Operations Update, ERCOT Board Meeting, March 18, 2003, p. 3.

relevant parties performed during the event. Specifically, the Commission should examine ERCOT's performance during this time in gaining a full understanding of what transpired during the event so as to prevent similar occurrences. Sam Jones' presentation to the ERCOT Board noted that ERCOT significantly under-predicted peak loads during the ice storm and failed to procure sufficient reserve capacity.[7] This would have required ERCOT to obtain far more balancing energy than the market had expected and planned to supply. Significantly, the report notes that ERCOT did not receive sufficient balancing energy bids to cover the shortfall. The report also noted that ERCOT may not have adequately developed resource plans for that period or analyzed balancing energy bids effectively. This discussion is not intended to "blame" ERCOT for the balancing energy bids—to the contrary, it suggests that the balancing energy bid process is highly interactive and responsive to numerous factors, including ERCOT forecasts and operations. One cannot simply conclude that any high bid always represents market participants attempting to "hit the jackpot," as the Staff has characterized it. This discussion also illustrates the inherent difficulty in implementing single-issue solutions to a dynamic market to react to a one-time event. Unless the Commission fashions alternatives that account for all factors producing the bid results it considers undesirable, a solution such as the CSM or MCSM which focuses only on certain factors cannot completely succeed in achieving the Commission's policy goals.

Finally, the case has not been established for immediately adopting the MCSM without further study. The instructive briefing exchange on the issue reveals that the Staff has not considered how introducing the CSM or MCSM will affect market participant or ERCOT behavior on a dynamic basis. The Staff apparently has taken the

[7] Id., p. 8.

CSM and applied it to market results achieved at a time when the MCSM or CSM did not apply. This analysis therefore could not have considered how introducing the MCSM will influence other market behavior. When challenged that the data on which the Staff relied could just as easily reflect a healthy market functioning as competitive markets do, the Staff has essentially relied on three arguments.

The first is that the CSM or MCSM is necessary to prevent anti-competitive behavior resulting from market power. Yet, the Staff has defined anti-competitive behavior as the point at which the CSM test is failed. In essence, the Staff seemingly has failed to find any market power abuses, and has defined market power as failing its own model. The Staff expressly refused to explain, however, why its test represents an appropriate definition of market power. All it has established it that its model will reduce bid prices in particular circumstances—it has not shown that the circumstances in which it operates always constitute anti-competitive conditions, except to define the concept in terms of its own test. This essentially results in the MCSM or CSM suppressing all price spikes resulting when ERCOT deploys all eligible bids, whether those bids represent market manipulation or legitimate business actions.[8]

Second, the Staff has cautioned that, even in the absence of any evidence that any market participant has attempted to manipulate the market through its balancing energy bids, without its model future "Enrons" or "Californias" will result.[9] Leaving aside the unfortunate hyperbole, these examples at best prove only that the Commission should adopt some sort of market mitigation tool, but not necessarily the MCSM or CSM. It

[8] The Staff appears to want to force all bids to reflect a generator's average marginal cost at all times, rather than rely on market forces to reach this result. CPA agrees with Reliant Resources' observations on the dangers inherent in using regulatory means to reach this result. See Reliant Resources, Inc.'s Response to Staff Proposal of March 18, 2003, March 20, 2003, p. 2.
[9] Commission Staff's Reply to Austin Concerning Staff Report, January 12, 2003, pp. 1, 4.

may well be that the Commission should adopt a mitigation strategy; these empirical examples and the ice storm event, however, do not particularly show that the Staff's proposal to the exclusion of other methods should prevail without any further scrutiny. Indeed, the California argument proves the point against adopting the MCSM without sufficient analysis. The FERC recently concluded that flawed market design and inconsistent market rules made possible the rolling brown-outs and market abuse.[10] Ill-conceived market rules facilitated California's problems. Texas should learn from this example and decline to adopt hasty solutions lacking empirical study.

Finally, the Staff has asserted that the MCSM will "work" but that means only that when applied to historic data, it would have changed the data to a different, presumably more acceptable point. "Work," as the Staff uses the term, does not mean that on a going-forward basis, when market participants and ERCOT react to a market in which the MCSM applies, the same results would occur in future situations as reflected in its post-event studies. The Staff has expressly declined to perform any further analysis to show how the MCSM or CSM would affect market participant and ERCOT behavior, stating that "CSM has been in the making for a year and a half."[11] Of course, the Staff has not analyzed the MCSM for a year and a half. Rather, it apparently devised the MCSM within three weeks after the ice storm. The Commission should, however, carefully study the PSEG e-mail that Commissioner Perlman filed in this docket on March 26th.[12] Mr. Chandley noted that the MCSM could produce the opposite result of

[10] FERC Press Release of March 26, 2003, p. 1.
[11] Commission Staff's Reply to Austin Concerning Staff Report, January 12, 2003, p. 9. Interestingly, the year and a half figure is the amount of time this docket has been pending. Much of this time was spent addressing the pre-assigned congestion rights issue, not the CSM issue.
[12] March 25, 2003 e-mail of Laura Manz, contained in Commissioner Perlman's filing in Central Records, March 27, 2003.

incentivizing generators to bid even greater prices so that the 90% rule does not lower their received price. He illustrates how even regulatory responses to such behavior may not prevent it. Indeed, Mr. Chandley illustrates how "hockey stick" bidding does not particularly reflect an attempt to "hit the jackpot," but instead can reflect a generator's true marginal costs, to which the Staff's MCSM seeks to limit all ancillary service bids.

CPA therefore recommends that the Commission continue to study the MCSM but not adopt it immediately. CPA supports Reliant Resources' suggestion of considering this issue in a rulemaking, and does not oppose its procedural schedule proposal.

CPA commits to fully engaging with the Staff and other parties on these issues and reaching consensus solutions that promote a healthy, effective, and fair wholesale market.

RESPECTFULLY SUBMITTED,

Marianne Carroll
State Bar No. 03888800
Chris Reeder
State Bar No. 16692300
CARROLL, GROSS, REEDER & DREWS, L.L.P.
701 Brazos, Suite 970
Austin Centre
Austin, Texas 78701
512/320-5951
512/320-5920 (FAX)

Certificate of Service

I certify that a copy of this document was served on all parties of record in this proceeding on April 3, 2003, by regular mail.

Chris Reeder

FEDERAL ENERGY REGULATORY COMMISSION

WASHINGTON, D.C. 20426

NEWS RELEASE

NEWS MEDIA CONTACTS:
Barbara Connors, Celeste Miller,
Hedley Burrell, Bryan Lee
(202) 502-8680

FOR IMMEDIATE RELEASE:
March 26, 2003
Docket No. PA02-2-000

COMMISSION READIES TOUGH ACTION BASED ON STAFF REPORT CITING MARKET MANIPULATION, OTHER VIOLATIONS

After an exhaustive 13-month investigation into behavior that may have caused dramatic price spikes in the California energy markets in 2000 and 2001, the staff of the Federal Energy Regulatory Commission today concluded that an underlying supply-demand imbalance and flawed market design combined to make a fertile environment for market manipulation. The Commission reacted to the report by taking strong additional enforcement actions.

Chairman Pat Wood, III commented: "This is all part of our role as the cop on the beat. We have said from the beginning that a belief in the free enterprise system goes hand in hand with a responsibility to see that the playing field is level and that everyone plays fair. If there was ever any doubt that this was part of our core philosophy, that doubt should now be dispelled."

The Commission said it would make public most of the material obtained in the course of the staff investigation. The more than 2 terabytes of material compiled is the equivalent of 1.5 million floppy diskettes or 3,341 compact diskettes. It will be placed on the Commission web site – www.ferc.gov – under "What's New" at 5 p.m. EST today.

The staff reported there was clear evidence of market manipulation in the western markets. But the manipulation was effective largely because of an underlying supply shortage, flawed market design and inconsistent rules, which exacerbated the impact of manipulation on high prices.

The Commission has consistently emphasized that standard market rules, adequate infrastructure and appropriate market monitoring and enforcement are the foundation for strong competitive energy markets.

In response to the Final Staff Report, the Commission announced today it will be taking

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strong additional enforcement actions against a number of electric and gas market participants. The first steps, issued today, are orders initiating proceedings to revoke market based rate authority for certain marketers of gas and electricity.

The Commission today also announced a series of aggressive upcoming actions it will undertake to ensure that problems such as those California experienced will not happen in energy markets in the future.

On February 13, 2002, the Commission moved quickly to address concerns that Enron Corp. may have used its market position to distort electric and gas markets in the West. The Commission directed staff to begin a fact-finding investigation into whether any entity manipulated short-term energy prices in electric or natural gas markets in the West, or unduly influenced wholesale prices since January 1, 2000. In conducting this broad investigation, staff was directed to "obtain information on any and all matters relevant to potential market manipulation in the West . . ." In August 2002, the Staff released its initial report and, acting on the report's recommendations, the Commission launched three company-specific investigations into possible misconduct by energy companies (EL00-113; EL00-114; EL00-115).

Today the Commission is releasing the Staff Final Report and the following include the Commission actions based on the Staff findings.

Future actions based on staff recommendations

1. Alleged manipulation of natural gas markets
   The Commission, in the near future, will initiate a generic proceeding to consider whether to change the Commission's regulation to require monitoring and reporting that would mandate companies disclose behaviors within certain defined limits or risk losing their certificates to trade gas. Power marketers would have to meet similar requirements.

2. Reporting of Price Indices
   Staff states that five entities admitted that their traders provided false information on natural gas transactions. Based on data requests, other entities may also have engaged in similar behavior. The Staff concluded that the publishers of gas price indices lack systematic reporting procedures and internal verification processes.

   The Commission intends to establish generic and company-specific proceedings to implement Staff recommendations. Among the recommendations are:

   - condition all electric market-based rates and natural gas blanket marketing certificates on the companies providing complete, accurate and honest

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information and retaining all relevant data needed to reconstruct published price data for three years.

- require that any published price indices for Commission-jurisdictional transactions be subject to audit.
- encourage standard product definitions for published natural gas and electricity prices indices and standard methods of calculation.

In addition, staff recommended that the reporting companies demonstrate that their internal processes for reporting have been corrected. Staff recommended that:

- the employees who participated in the manipulations be disciplined.
- energy companies have a clear code of conduct.
- all trade data reporting be done by an entity within the company that does not have a financial interest in the published index.

3. Enron trading strategies

As a result of Enron's various strategies which exploited the California market rules, including the use of false information, the Commission will issue show cause orders and initiate investigations.

4. Wash trading

The Commission will establish specific rules banning any form of prearranged wash trading and prohibiting the reporting of any affiliate trading activities through industry indices.

5. Electronic trading platforms

The Commission plans to condition blanket gas marketing certificates, as well as electric market-based rates, to require that sellers who use trading platforms use only those trading platforms that agree to provide the Commission with full access to trade reporting. The trading platforms must also agree to appropriate monitoring requirements.

In a November 20, 2002 order the Commission allowed parties in the California refund proceeding to conduct additional discovery into market manipulation (Docket No. EL00-95, et al.) during the period January 1, 2000 to June 20, 2001. The new material submitted by the parties indicates that the generators may have engaged in physical withholding of generation. Today the Staff will be sending a data request to the relevant entities regarding allegations of physical withholding.

The staff report is available on the Commission's website at www.ferc.gov under "What's New."

R-03-14

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Operations Update

ERCOT Board Meeting
March 18, 2003

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Operational Events of February 24-26, 2003

Weather Conditions:
Below freezing temperatures for all but South Texas with freezing precipitation

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Monday, February 24

- 06:00 - Load forecast peak of 37,811 MW @ 20:00. Actual peak was 42,029 MW @ 20:00

- 11:00 - Began receiving reports of gas curtailments and issued Operating Condition Notice. Began canceling planned transmission outages

- 17:50 - Issued a Market Alert due to insufficiency of UBES bids. Provided VDIs to increase generation. Raised RMR units to maximum.
  - Using 6,094 MW of UBES for interval ending 18:00
  - Only had 4,777 MW in bid stack for hour ending 19:00

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Monday, February 24

- 18:10 - Issued a Transmission Alert. Exceeding limits on Morgan – East in order to avoid reducing generation
- 19:08 - Conducted Hot Line call to review EECP procedures with QSEs
- 19:30 - Started ending VDIs as load began to decline
- MCPE was $990 from 18:00 – 19:45

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Tuesday, February 25

- 02:45 - Market and Weather Advisory issued due to gas curtailments and inclement weather

- 07:00 - Transmission Alert again issued for Morgan-East to allow for full deployment of West Texas generation

- 07:30 - All available UBES deployed. Market Advisory issued requesting more bids and VDIs issued to increase generation. NSRS fully deployed by 09:00. MCPE $990 from 07:30 – 11:15

Tuesday, February 25

- 09:30 – 3 QSEs informed ERCOT their gas suppliers required them to curtail usage to “Human Need” levels. ERCOT COO signed affidavits that generation was for human needs.

- 11:30 – A gas supplier cut supply to a plant with 745 MW generation. Frequency declines to 59.81 Hz. ERCOT total SCE –1,500 MW

- 12:01 – ERCOT declares Emergency Electric Curtailment Plan (EECP) Step 1 requesting all QSEs to bring on line all available generation and bid it into the BES market

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Tuesday, February 25

- 12:30 – Frequency and SCE restored to normal levels
- 13:00 – Day Ahead Ancillary Service Market cleared for next day with $999 clearing prices for URS and RRS for a number of hours. RRS deficient 7-140 MW for 20 hours
- 19:30 – EECP Step 1 terminated
- Continued cold weather through February 26, but no significant operating events

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Lessons Learned

- **Accurate Weather Forecasts are Critical**
  - Few weather services (including ERCOT's) predicted the magnitude of low temperatures or their duration
  - More accurate forecast would have caused ERCOT to procure more Non-Spinning Reserve
  - ERCOT will determine if there are better weather services
- **Accurate Resource Plans are Critical**
  - ERCOT system always showed plenty of reserves
    - Resource plans may not have reflected de-ratings due to gas curtailments or fuel oil burning (5,495 MW curtailed, 3,220 MW picked up on oil)
  - Not all UBES bid deployed due to Resource Plan limitations
  - QSEs were called to discuss Net Dependable Capabilities
  - PRs 30067, 30072, 30131 in pipeline. Raise priority?
  - Starting pilot QSE Resource Plan performance measures

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Lessons Learned

- **Need tools to assess adequacy of Balancing Bids further in advance**
  - Bids cannot be submitted during Operating Period (1-2 hours before real time)
  - Resulted in numerous VDIs and OOMEs

- **Further Consideration**
  - Was the gas supply problem:
    - Only short term due to the temporary weather and “El Nino” phenomenon or indicative of future long term problems?
    - Due to less “firm” contracts/more reliance on spot market?
    - Reason to change ancillary service or generation adequacy requirements?

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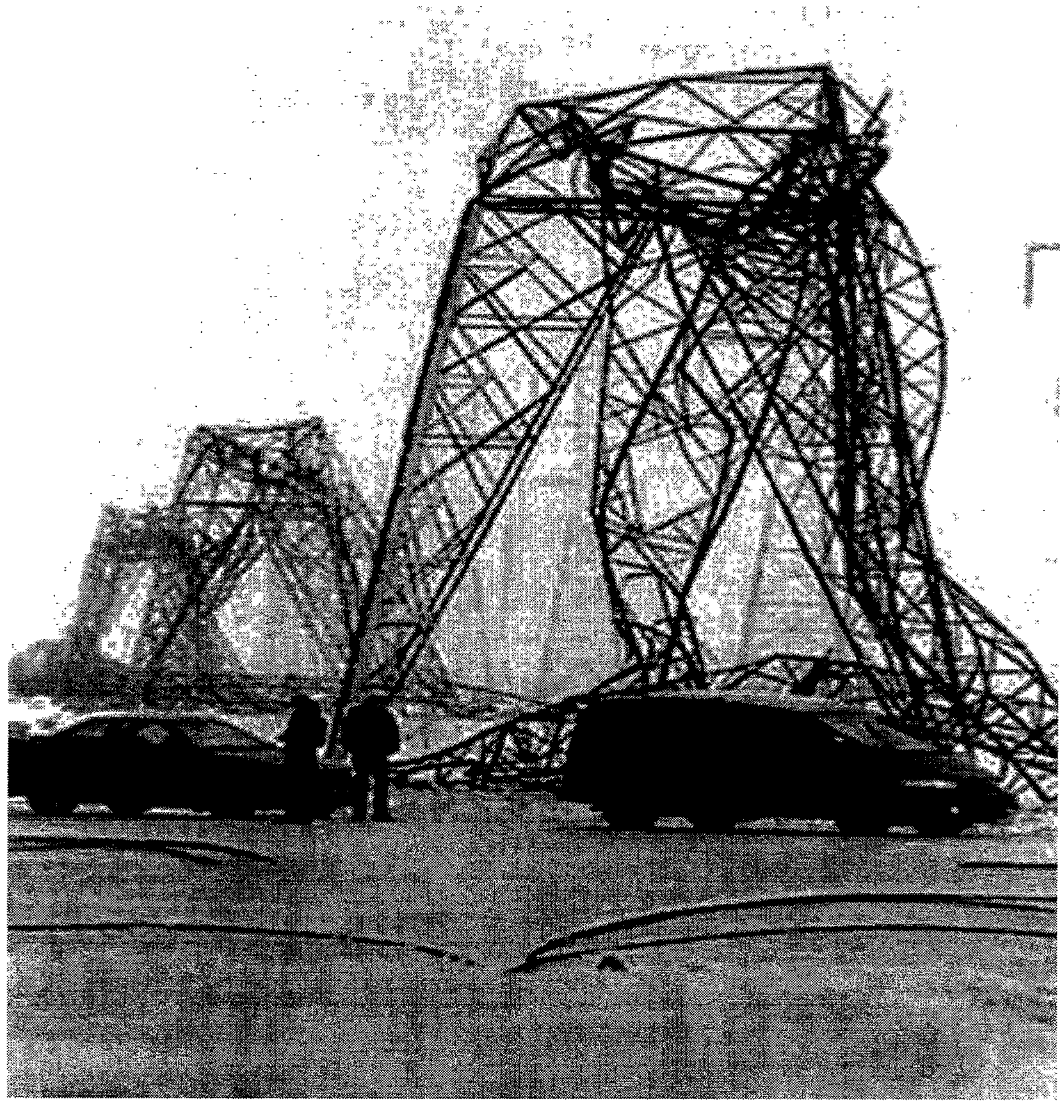
It Could Have Been Worse!



February 24-26 ERCOT Ancillary Service and Balancing Markets

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Ancillary Services *

Capacity Cost (million $)

Date	DRS	URS	RRS	NSRS	OOMC	Total
Avg. Prev. Wk.	$0.06	$0.09	$0.23	$0.04	N/A	$0.42
2/24/2003	$0.05	$0.14	$0.20	$0.00	$0.89	$1.28
2/25/2003	$0.11	$0.51	$0.24	$0.53	$0.42	$1.81
2/26/2003	$0.09	$6.89	$13.97	$0.00	$2.43	$23.38
Total	$0.25	$7.54	$14.41	$0.53	$3.74	$26.47

Average Price/MW

Date	DRS	URS	RRS	NSRS
Avg. Prev. Wk.	$7.95	$13.10	$13.41	$55.00
2/24/2003	$6.81	$15.36	$11.54	N/A
2/25/2003	$11.68	$69.47	$15.47	$162.97
2/26/2003	$10.25	$851.57	$962.62	N/A

* All figures not final

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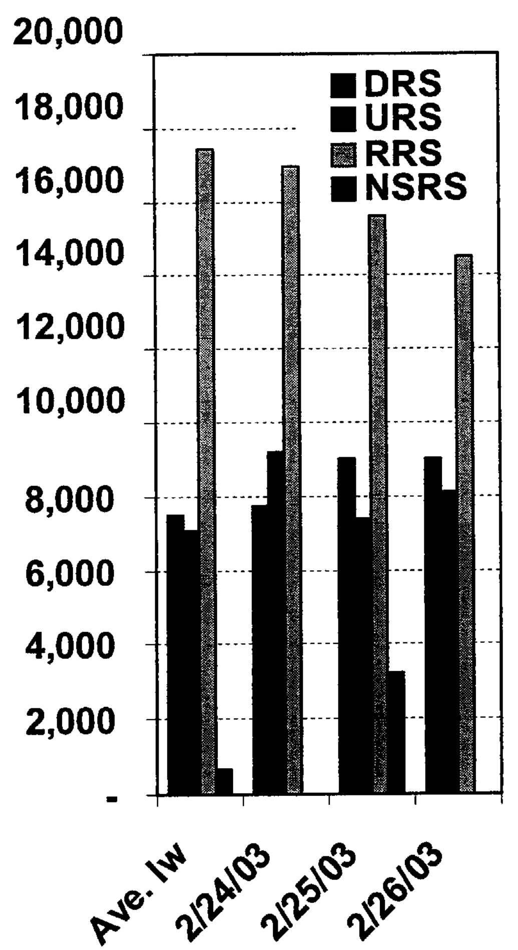
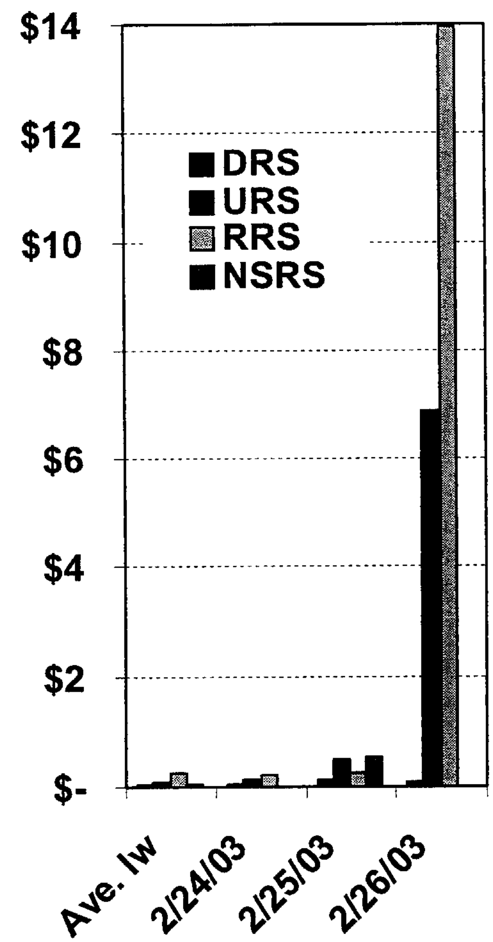
Ancillary Services

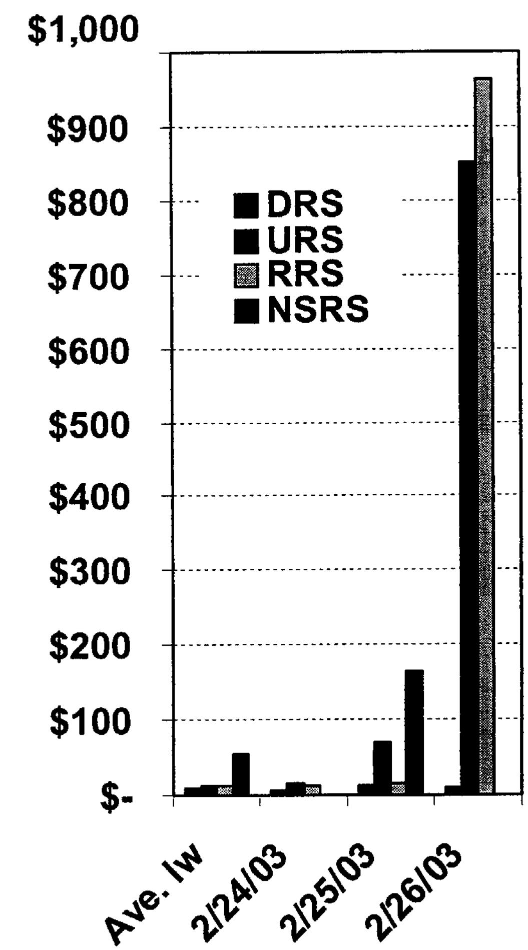
Procurement (MW)



Cost (Million $)



Average Price ($/MW)



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Balancing Energy*

Balancing Energy Cost (million $)

Avg. Prev. Wk.	2/24/2003	2/25/2003	2/26/2003	Total
$2.53	$23.34	$45.33	$13.84	$82.51

Average Price/MWH

Avg. Prev. Wk.	2/24/2003	2/25/2003	2/26/2003
$55.43	$245.76	$517.31	$206.62

Balancing as % of ERCOT Total Energy

Avg. Prev. Wk.	2/24/2003	2/25/2003	2/26/2003
6.2%	11.1%	10.4%	6.7%

* All figures not final

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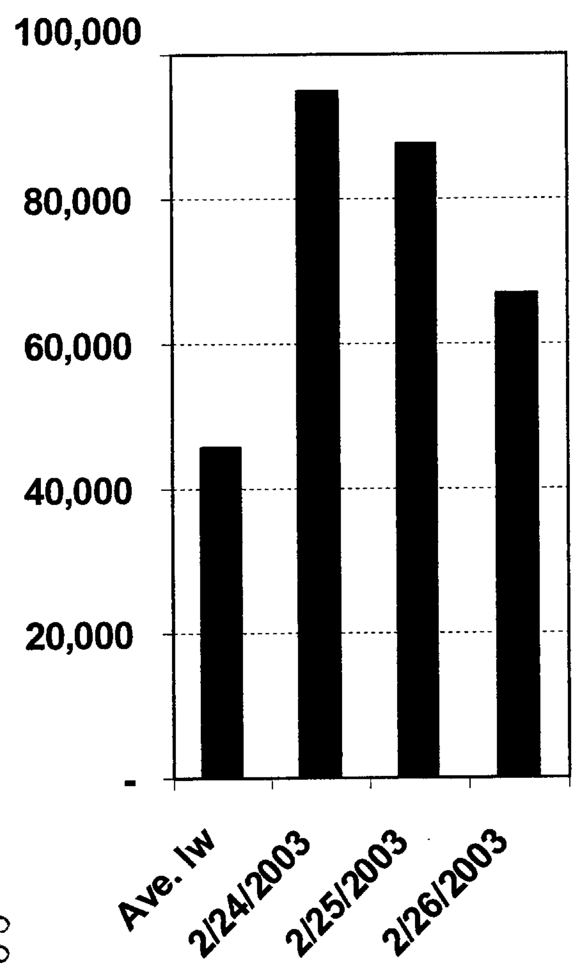
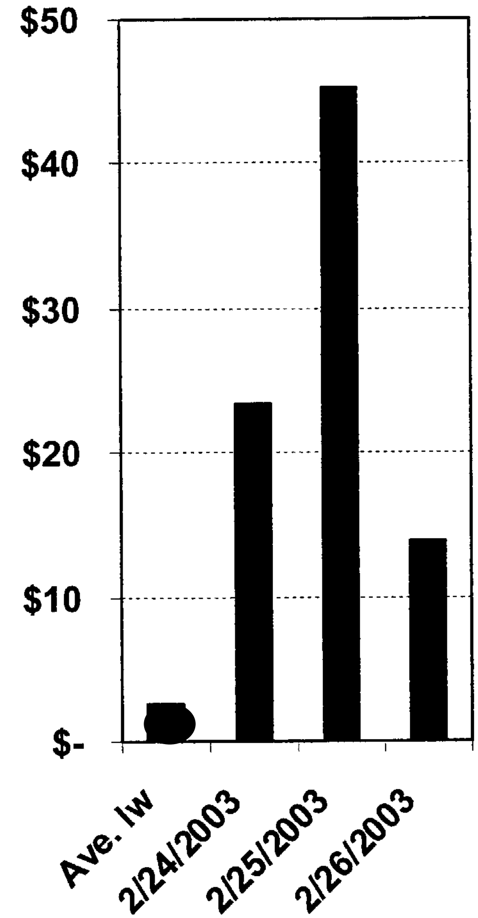
Balancing Energy

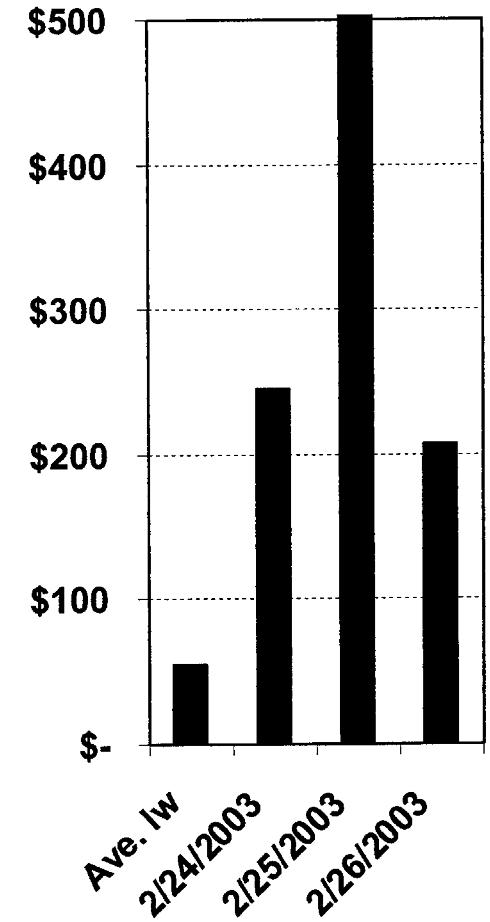
Deployment (MWh)



Cost (Million $)



Average Price ($/MWh)



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