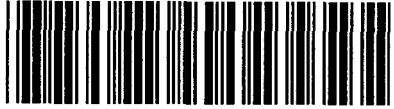




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PUC PROJECT NO. 24770

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

PUBLIC UTILITY COMMISSION

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LOWER COLORADO RIVER AUTHORITY'S COMMENTS
IN RESPONSE TO ORDER NO. 19

The Lower Colorado River Authority (LCRA) offers the following comments in response to Order 19 (*Scheduling Technical Conference; Setting Comment Deadline*) in this docket. LCRA has several concerns about Staff's proposed Modified Competitive Solution Method ("MCSM"), which are summarized below:

- Because the method doesn't distinguish between prices based on true scarcity and those resulting from bidding behavior and is triggered only by exhaustion of the bid stack, the method may lead to price distortion and dampening of legitimate scarcity prices.
- The MCSM may have the unintended effect of encouraging greater reliance on volatile ERCOT-run ancillary service markets, particularly Balancing Energy Service, rather than on bilateral contracts, because prices may be artificially dampened.
- The method may result in price inconsistencies or "reversals." For example, the MCPE can go as high as \$990/MWh with several MWs left in the bid stack (and thus the method is not triggered), but may drop to significantly lower levels (e.g. \$500/MWh) when there is a greater need for Balancing Energy and the BES bid stack is exhausted.
- The method is likely incompatible with the effort to more finely granularize resource zones, because the MCSM test is based on zonal bid stack. This suggests that any mitigation should not target individual zonal bid stacks.
- For BES, the method may create gaming opportunities because of the disparity between zonal MCPEs and how congestion is charged (i.e. CSC Shadow Prices). We remain concerned about separation between information used to

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operate the system and make decisions in real time, and that used for settlement.

- For ancillary services capacity markets, the MCSM proposal lacks a method to determine MCPC to settle purchasers of the Ancillary Services whenever the “OOM” provision is triggered.

The Commission has also requested comments on proposals submitted by Reliant Resources and City Public Service of San Antonio. It appears to LCRA that these proposals have some of the same problems outlined above, although more details are required to properly analyze those proposals.

The offer cap of \$1000/MWh was roughly based on the value of non-interruptible load loss, and roughly the price needed for a simple cycle combustion turbine to break even. If no capacity is physically withheld and ERCOT exhausts the BES bid stack, then MCPE can be expected to approach the offer cap reflecting the scarcity in the market. For the owner of the combustion turbine to break even, its offer price would have to be close to the offer cap even though its marginal cost is closer to \$75/MWh at \$5.00/MMBTU gas price. Of greater concern is when the BES bid stack is exhausted due to physical withholding by pivotal bidder(s) or MCPE approaches the offer cap due to financial withholding by pivotal bidder(s). If the demand and supply situation in the market is such that the pivotal bidder(s) can profit from physical and/or financial withholding on a sustained basis (even though their bids did not set the clearing price), then MOD can take corrective action against those entities, which may include requiring such entities to submit cost based offers. Smaller non-pivotal bidders can only afford to offer a small portion of their available capacity at high prices and can only benefit on a sustained basis if there's withholding by pivotal bidder(s) (i.e. entities with market power). Since all entities are bidding below the offer cap, the “verifiable cost” provision should not be automatically invoked. If the Commission now thinks that the offer cap is unreasonable and equivalent to gouging, then it should re-examine the offer cap, but should not impose an additional “verifiable cost” based cap on all entities. The Commission should only selectively impose “verifiable cost” based bidding on entities with market power (individually or through collusion) that the Commission determines have manipulated prices to increase

profits on a sustained basis. In such cases, the “verifiable cost” definition developed by the ERCOT RMR Working Group is a good model.

LCRA Alternative Proposal

Mitigation may have a significant undesirable effect because it cannot distinguish between true shortages and those caused by errors or weakness in certain aspects of the market design. Most, if not all, of the price spikes in ERCOT to date have been the result of “mistakes” by either ERCOT or market participants. LCRA’s preferred approach would address this in a straightforward manner that allows market participants another bite at the apple when mistakes are made. Extending day ahead markets and posting indicative prices for BES will give market participants time to react in ways that will mitigate the impacts of such mistakes.

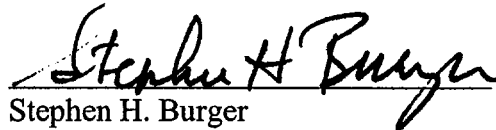
For the day-ahead AS capacity markets, LCRA supports certain aspects of the MOD proposal, with the following important modifications:

- Perform the Competitive Sufficiency Test with the second condition changed to “One or more Pivotal Bidders exist” instead of “The MCPC is set by a Pivotal Bidder.” The reason for this change is that a Pivotal Bidder is aware that he does not have to bid high but can simply withhold to have the high bid of another bidder set the MCPC that he receives.
- If the bid stack fails this test, then ERCOT should extend by one hour the Day-Ahead Market and post indicative MCPCs. The bidding rules for this market can be as described in the MOD proposal.
- After the close of the Extended Market, ERCOT shall determine new MCPCs and shall apply these to all quantities procured for those hours.
- The process would end at this point. As others, including Austin Energy and MOD, have previously pointed out, the ERCOT market reacts well to high prices. The reaction to high MCPCs were delayed by one day since the Day-Ahead Market is a single round auction and does not lend itself to immediate reaction. By

ERCOT extending the market by one hour and publishing indicative high prices, the reaction should be immediate and thus result in lower MCPCs.

A similar concept can be applied for the BES market as well. For February 24-26, 2003, ERCOT should have acquired Replacement Reserves if it had any indication of the severe cold front hitting Texas. If ERCOT is unable to predict such an event day-ahead and forecasts a shortage of BES offers in the Operating Day, ERCOT should then ask that all available capacity bid into BES market an hour ahead of the operating hour and then post indicative prices to encourage additional bilateral contracting and BES bids. Mitigation against market power abuse can be handled by MOD as described above.

Respectfully submitted,

A handwritten signature in black ink, reading "Stephen H. Burger". The signature is fluid and cursive, with the first name "Stephen" and last name "Burger" clearly legible. The middle initial "H" is smaller and positioned between the first and last names.

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