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Item Number: 4

Addendum StartPage: 0

PROJECT NO. 51871

REVIEW OF THE ERCOT
SCARCITY PRICING MECHANISM

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PUBLIC UTILITY COMMISSION
OF TEXAS

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COMMENTS OF POTOMAC ECONOMICS

Potomac Economics (Potomac), the Independent Market Monitor (IMM) of the Electric Reliability Council of Texas (ERCOT) wholesale electricity market for the Public Utility Commission of Texas (Commission), appreciates the opportunity to file the following comments regarding the low system-wide offer cap (LCAP) in Project No. 51871, *Review of the ERCOT Scarcity Pricing Mechanism*, and to answer the following questions:

1. Should the Commission amend its rules to adjust the LCAP?
2. If the Commission amends its rules to adjust the LCAP, what specific adjustments should it make?
3. If the Commission amends its rules to adjust the LCAP, when should these adjustments take effect?

1. Should the Commission amend its rules to adjust the LCAP?

Yes, the Commission should amend its rules to adjust the LCAP. For the first time since the advent of the nodal market, generator revenues breached the peaker net margin (PNM) threshold (currently set at \$315,000/MW per year, established in 16 Tex. Admin. Code (TAC) § 25.505(g)(6)) this year, triggering the LCAP. As provided in 16 TAC §25.505(g)(6)(D), once the PNM threshold is achieved, the system-wide offer cap is set at the LCAP, which is the greater of either:

- (i) \$2,000 per MWh and \$2,000 per MW per hour; or

- (ii) 50 times the natural gas price index value determined by ERCOT, expressed in dollars per MWh and dollars per MW per hour.

The purpose of the system-wide offer caps rule in 16 TAC § 25.505(g)(6) is to protect consumers from excess wealth transfers in years with substantial generator revenues, to the extent that the Commission desires to provide such a “circuit-breaker.” However, unintended consequences may occur if the natural gas price index is much higher than average. The IMM recommends the following specific adjustments to the LCAP to better serve that purpose.

2. If the Commission amends its rules to adjust the LCAP, what specific adjustments should it make?

It is important to carefully balance the needs of generators to earn rent to recover fixed costs in times of scarcity with the need to limit unreasonable transfers of wealth from customers and their load-serving entities. This is especially true when natural gas prices are much higher than the typical values. Since there is no cap on natural gas prices, and frequently natural gas generators are marginal for those prices, a high gas multiplier in the wholesale electric market can have the circular effect of raising gas prices in times of scarcity. The IMM recommends that the multiplier for natural gas be lowered to 25 from 50, while at the same time ensuring that LCAP does not exceed the high system-wide offer cap (HCAP) in 16 TAC §25.505(g). This should prevent unintended consequences in those periods while also acknowledging that natural gas generators are typically on the margin during scarcity conditions and need to recover their marginal costs. A 25 heat-rate equivalent should exceed the marginal costs of any generator in ERCOT.

Specifically, the IMM recommends that the Commission adjust the Scarcity Pricing Mechanism in the following ways:

- Modify LCAP to be the greater of 25 times the natural gas price index value determined by ERCOT or \$2,000/MWh, with a maximum value equal to HCAP.

Due to exceptionally high natural gas prices during the recent February 2021 winter event, the LCAP would have been calculated as 50 times the natural gas price index value at the time and exceeded the HCAP of \$9,000 per MWh and \$9,000 per MW per hour.¹ To prevent LCAP from exceeding HCAP, the Commission intervened to suspend any use of the LCAP and continue to use the HCAP as the system-wide offer cap.²

3. If the Commission amends its rules to adjust the LCAP, when should these adjustments take effect?

The proposed change to the LCAP multiplier will right-size the cap with the prevailing natural gas prices without providing for excess wealth transfer in scarcity conditions. The LCAP adjustment should take effect as soon as possible, preferably by May 1, 2021, before the summer of 2021, and it is a configurable parameter in ERCOT's systems.

¹ 16 TAC § 25.505(g)(6)

² PUC Project No. 51617, Calendar Year 2021 – *Open Meeting Agenda Items without an Associated Control*; Second Order Directing ERCOT to take Action and Granting Exception to Commission Rules at 2 (Feb. 16, 2021); PUC Project No. 51812, *Issues Related to the State of Disaster for the February 2021 Winter Weather Event*, Order Directing ERCOT to take Action and Granting Exception to Commission Rules at 3 (Mar. 1, 2021).

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Respectfully submitted,

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