Texas Industrial Energy Consumers' Statement of Position
Appeal of TAC Action on PRR776
February 12, 2009

In order to provide the Board with a complete picture of the reasons that TIEC has submitted and advocated for PRR776, TIEC offers the following statement of position to supplement the appeal it filed on February 6, 2009.

1.   PRR776 is Necessary

The current ERCOT protocols eliminate price transparency during intervals when it is most important, and this is causing significant harm to the electricity market. Specifically, *ex poste* pricing related to Non-Spinning Reserve Service (NSRS) has greatly impaired Load's ability to respond to prices, which TIEC considers to be critical to a properly functioning market. TIEC believes that the harm to Loads was not fully appreciated when PRR650—the protocol change that created this issue—was approved and implemented. Since that time, the serious negative impacts of PRR650 have become readily apparent, and TIEC urges the Board to take action to prevent further harm.

Prior to the adoption of PRR650, the deployment of NSRS often depressed spot energy prices, compared to intervals when NSRS was not deployed. This price depression sometimes occurred during periods when there was a significant shortage of energy. The reason for this effect was that deployment of NSRS injected "free" energy onto the grid, which reduced the need for spot energy and caused the spot market energy clearing price to be set by a cheaper unit than if the deployment had not occurred. The proponents of PRR650 successfully argued that spot energy prices should reflect shortage conditions *when real shortage conditions exist*. TIEC agrees with this concept. However, PRR650 was implemented in a way that involves after-the-fact price restatements for intervals of NSRS deployment. This has completely eliminated price transparency during those intervals. The PRR650 price adjustments have also resulted in prices that reflect shortage conditions *when no shortage actually exists*. Not surprisingly, these aspects of PRR650 have had a profound negative impact on Loads and Load response.

Under PRR650, the Market Clearing Price for Energy (MCPE) is adjusted *ex poste* when NSRS is deployed to reflect the MCPE that would have occurred if NSRS had *not* been deployed. In other words, the existing protocols assume that the energy supplied through NSRS deployment is always the highest cost energy on the system. As previously mentioned, there are two distinct issues created by this change. The first stems from the ex poste nature of the spot energy price. The price adjustments have varied widely—from $0/MWh to nearly $2000/MWh—so it has been impossible for price-responsive Loads to determine whether or not to respond in real time. The effect on price exposure has been substantial.

Take the following example: Suppose that a price-responsive Load has determined that it has 50 MW available to be turned down in response to the price during high-cost periods. The Load monitors the published MCPE on the ERCOT website to determine whether to reduce its consumption. On a particular day, the published MCPE averages $50 per MWh. This would

result in the Load paying $60,000 total for that day.[1] However, NSRS is deployed for three hours that day, during which the average posted MCPE was $80 per MWh. Two days later, the Load receives a notice that the MCPE was adjusted upward under the current repricing mechanism to an average of $2,000 per MWh for those three hours. Instead of the $60,000 in costs that the Load thought it had incurred, the total price for the day will be $348,000.[2] This is a cost increase of 580%, applied to power that had *already been consumed*, without giving Load any notice of the adjusted price or that there would even be an adjustment.

In addition to the *ex poste* nature of the PRR650 price adjustments, the adjusted prices themselves are also problematic because they reflect an energy shortage when none actually exists. Just as the pre-PRR650 protocols improperly assumed that the energy injected onto the grid from NSRS deployment was free, the post-PRR650 protocols improperly assume that this energy is at the highest energy offer for that interval. The impact of this assumption is to inflate spot energy prices toward the other extreme. This undermines the pivotal concept in an energy-only market design that prices should accurately reflect market conditions. When this improper pricing is coupled with a complete lack of transparency due to the *ex poste* price adjustment, the result is to completely undermine the efficient operation of the market—particularly the ability of Loads to respond to prices and control their own destiny.

There are many price-responsive Loads in the ERCOT market, and there are many products that are designed to facilitate Load curtailment once the MCPE reaches a certain level. The lack of transparency and the *ex poste* pricing of PRR650 makes Load response impossible when NSRS is deployed, and TIEC members have confirmed that this is driving Load away from price-responsive products. Even more fundamentally, a properly functioning market should allow Load to determine the price it will pay for power, and to react to it, *before* actually consuming that power. This is an essential element of a well-functioning market, and it is thwarted by the existing PRR650 repricing mechanism.

The current after-the-fact repricing system is driving beneficial price-responsive Loads out of the spot market. PRR776 will restore this Load response by increasing the transparency of pricing during NSRS deployment and avoiding after-the-fact price restatements.

2.   PRR776 Should Not be Combined with PRR791

Contrary to the views of some, PRRs 776 and 791 are not inextricably linked, and the passage of one should not be contingent upon the passage of the other. PRR776 is designed to address a very specific mechanism (PRR650) that has resulted in significant harm to the market in relation to NSRS deployment. In contrast, PRR791 is designed to address *overall* shortage pricing—an issue that goes far beyond the scope of PRR776 and is also the subject of an existing Commission rule.[3]

PRR 776 will not be improved by coupling it with PRR791, nor will it be improved by further delay or negotiation. PRR776 has been in the vetting process since before it was filed last

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[1] 50 MW x 24 hours x $50 per MWh = $60,000 per day.
[2] $60,000 (original total) – (3 hours x $80 per MWh x 50 MW) + (3 hours x $2,000 per MWh x 50 MW) = $348,000
[3] P.U.C. Subst. R. 25.504.

August, and it has been subjected to months of rigorous analysis and revision. Linking PRRs 776 and 791 will accomplish nothing more than to delay resolving the harm that is currently being caused by the PRR650 repricing scheme.

An IMM chart produced during the discussions on PRR791 showed that in 2007, PRR791 could have added as much as $1 billion in increased costs to the market. There have been discussions that the additions could be much higher in the future. While TIEC supports efficient pricing, and proper shortage pricing, PRR791 has not been vetted sufficiently for TIEC to support it at this time. TIEC is committed to working with the Stakeholders to determine what mechanism, if any, is needed and in what manner it should be implemented. However, TIEC submits that the correct answer to the issues raised by PRR791 is not yet known. In contrast, PRR776 has been fully vetted, and it is ready to be adopted and implemented.