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ERCOT Board of Directors
7620 Metro Center Drive
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Re: Position Statement - PRR 776 and PRR 791

I offer this Position Statement on behalf of GEUS of the Municipal Market Segment.

PRR 776

PRR 776 should be approved as a standalone PRR. I voted in favor at the February and March TAC meetings.

The intent of PRR 776 is to eliminate the current practice of after-the-fact price adjustments when NSRS is deployed that has been in effect since PRR 650 was adopted. After-the-fact price adjustments prevent price-responsive loads from reacting to prices in Real Time. It is incredibly unfair to both buyers and sellers to not know in real-time what price is to be paid. It's a crazy way to run a market. In the lengthy deliberations that have taken place at TAC, I have heard no one say that it is not a good idea to develop a real time price mechanism.

The proponents of PRR 776 have worked diligently and patiently with other stakeholders to modify the original language to more acceptable terms. However, within the last few months, an effort was made to incorporate PRR 791 language into 776. One commenter stated that PRR 776 has been hijacked by proponents of the administrative scarcity pricing scheme called for in PRR 791. Many market participants, including me, found this unacceptable.

PRR 791

PRR 791 should not be approved, either as a standalone PRR, or in combination with PRR 776. I voted against PRR 791 bundled with PRR 776 at the February and March TAC meetings.

This PRR, either as a standalone or in combination with PRR 776, introduces an administrative scarcity pricing scheme when NSRS is deployed under certain conditions.

Concerns with PRR 791 include the following:

1) **PUCT considered and rejected this concept.** In Project No. 31972, the PUCT considered and rejected this concept, "…***the commission does not see the necessity of adopting additional measures to ensure scarcity pricing and declines to amend the rule as suggested***…" Stakeholders will be criticized if PRR 791 is adopted and if its implementation subsequently results in significant market impacts. Recall the criticism TAC and WMS received last year for calculating shift factors that exceeded the PUC approved market cap.

2) **PRR 791 fixes the wrong problem.** The recent lack of "scarcity pricing" observed in the market appears to be due to fear of negative publicity, concern over possible PUCT sanctions or Legislative actions, or for other reasons that are keeping offers at low prices. If so, PRR 791 fixes the wrong problem.

3) **No additional incentives are necessary.** The argument that an administrative pricing scheme is necessary to insure scarcity pricing to incentivize new generation is contradicted by the massive quantities of generation additions (over 100,000 MWs) that are currently in the interconnection process queue. Generators that are looking for price signals before committing to locate in ERCOT must look ahead at least two years. Nodal will be in effect in December 2010 and the nodal protocols include an administrative pricing mechanism.

4) **Market impacts have not been studied in detail.** A detailed analysis has not been undertaken to estimate market costs, but the limited estimates that have been presented indicate that PRR 791 could increase wholesale market costs by anywhere from $203 to $750 million per year. Compare that potential increase in market costs to the $520 million per year in anticipated savings from implementation of Nodal (according to CRA's recent update). The potential increase in market costs due to PRR 791 could be greater than Nodal savings! This is a significant market change that warrants additional study and consideration by the PUCT.

Further discussion - PUC has considered and rejected the PRR 791 concept:

Included below is an excerpt of the PUC Order in Docket 31972, "RULEMAKING ON WHOLESALE ELECTRIC MARKET POWER AND RESOURCE ADEQUACY IN THE ERCOT POWER REGION", signed on August 23, 2006.

----Excerpt of PUC Order Docket 31972 – beginning on page 47----

> NRG stated that an energy-only mechanism must be augmented by other mechanisms that will dependably set very high prices whenever reserve levels are compromised or threatened. NRG called for the development of explicit reserve shortage energy-pricing mechanisms that can produce scarcity pricing without relying on offers from the market.

NRG stated that experience with chronically under-supplied markets in other regions suggests that as reserve margins erode, reliability is degraded and policymakers become increasingly concerned about the potential for sustained periods of high prices that could erode popular support for competition and that are easily confused with the exercise of market power, as was seen in the energy crisis in California. Joint Commenters stated that because the offer cap is applied to all generation units, not just those that could be used to abuse market power, the proposed rule's offer cap is not aimed at market power abuse.

Consistent with recommendations by Drs. Patton and Hogan, NRG proposed that energy prices be directly set at appropriately high levels when reserve levels are at risk of being degraded. Joint Commenters offered a different but comparable approach by suggesting that the commission add a new subsection in the rule to raise the offer cap to $10,000 per MWh when there is insufficient capacity offered in the market to meet ERCOT's ancillary service needs. Joint Commenters noted that this proposal addresses what it perceives as the failure of the rules to specify the conditions when scarcity pricing arises. NRG supported the Joint Commenters suggestions to modify the SPM. In its reply comments, CPS Energy recommended that the rule require an administrative demand curve but recommended that the specific mechanics should be reserved for resolution through the stakeholder process.

In its reply comments, ARM urged the commission to reject this approach. ARM expressed its strong opposition to administratively reducing scarcity pricing in balancing energy prices when reserves are depleted. ARM emphasized that scarcity prices have occurred under the existing rules within the bounds of the current caps. ARM stated that the proposed less-than-5% market power safe harbor mechanism will ensure that small entities will be able to attempt to extract scarcity rents through balancing energy prices when such entities are pivotal during scarcity conditions. These small entities will attempt naturally to induce scarcity prices into the market price for balancing energy. This situation is different than is found in the U.S. power market outside of ERCOT where there is no such market power safe harbor and market monitoring actions may be aggressive enough to preclude any entity from attempting to extract scarcity rents. Administratively inducing scarcity prices would amount to a subsidy like those that would be provided through capacity markets.

Joint Commenters, in its reply comments, expressed skepticism with ARM's assertion that the 5% market power safe harbor would permit sufficient scarcity pricing for the market because market participants would drive down the price towards short-run marginal costs unless there is true scarcity in the market, where scarcity is defined as involuntary load curtailment.

Commission response

The commission concludes that these comments are inconsistent with the actual experience in ERCOT markets. Prices in the balancing energy and capacity markets have reflected changes in supply and demand, and the relaxation of the existing pricing and bidding restrictions should result in prices that reflect the scarcity of resources. The commission also notes that the market has experienced high prices without a mechanism to administratively set prices during periods of scarcity. Furthermore, the nodal market protocols approved by this commission have such a mechanism, which incorporates administratively set high-priced energy offers into the real-time energy offer stack when ERCOT needs to deploy responsive reserve service in response to insufficient energy offers in the real-time market. As a result, the commission does not see the necessity of adopting additional measures to ensure scarcity pricing and declines to amend the rule as suggested by Joint Commenters and NRG.

---- End of Excerpt of PUC Order Docket 31972 – ending on page 49 ----

One could argue that the PUC was relying on the Nodal Market to be in place by now, which includes within the Nodal Protocols “a mechanism, which incorporates administratively set high-priced energy offers into the real-time energy offer stack” similar to what is proposed in PRR 791. But, the fact is that with regard to the current wholesale market, the commission considered and rejected “a mechanism to administratively set prices during periods of scarcity”.

Perhaps the PUCT, if presented with this PRR 791 concept in light of recent events, including minimal scarcity pricing events and the delay of the nodal market, might choose to reconsider their decision. But, in respect of the authority of the PUCT over ERCOT and the wholesale market, it is not prudent for stakeholders to implement a market design change that is contrary to a decision of the PUCT. ERCOT should support the decisions of the PUCT until such time as the PUCT decides to reconsider.

Respectfully submitted,

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