

MEMORANDUM

TO: ERCOT Board of Directors

FROM: Dan Jones
Director, Independent Market Monitor

DATE: December 1, 2011

RE: Holistic Approach to Congestion Irresolvable by SCED

At the September 20, 2011 meeting of the ERCOT Board of Directors, Potomac Economics as the Independent Market Monitor (“IMM”) for the ERCOT wholesale markets was requested, along with the Technical Advisory Committee (“TAC”), to provide input on the matter of the Holistic Approach to Congestion Irresolvable by SCED, including the information and calculations provided by South Texas Electric Cooperative, Inc (“STEC”).

As a general principle, the IMM supports efficient market pricing that is consistent with the reliability conditions at each location on the ERCOT system. In regard to the shadow price caps (or “penalty factor values”), the following objectives are stated in *Proposal for Initial Nodal Constraint Shadow Price Cap and Power Balance Penalty Factor Values* as approved at the November 6, 2008 TAC meeting:¹

The objective in establishing the levels of these penalty factor values is to provide an appropriate balance between ensuring reliable system operations, preventing inefficient redispatch, ensuring efficient pricing outcomes during locational or system-wide scarcity conditions, and observing the applicable system-wide offer cap levels.

When constraints such as the Valley Import are irresolvable by SCED, this is representative of locational scarcity conditions where prices should be consistent with the system-wide offer cap (“SWOC”) levels. Because of the highly radial nature of the Valley Import constraint, the prior shadow price cap of \$5,000 was excessive for this constraint in light of the SWOC of \$3,000. However, the interim shadow price cap of \$350 for the Valley Import constraint will not produce a price that is consistent with the reliability conditions when this constraint is irresolvable, thereby significantly reducing the price signals that promote market actions to improve reliable operations, such as new

¹ http://www.ercot.com/content/meetings/tac/keydocs/2008/1106/11_CMWG_20080827_Penalty_Factors_Comment.doc



resource development, demand response, DC tie scheduling practices, and resource outage scheduling practices.

For these reasons, the IMM supports the Holistic Solution to Congestion Irresolvable in SCED as adopted by the TAC. In regard to the additional information and calculations provided by STEC, I was present for the related TAC discussions, have reviewed the response to be presented to the Board by the TAC Advocate, and I am in general agreement with the position of the TAC Advocate on the observations relating to the additional information and calculations provided by STEC.

I will be present at the Board meeting for its consideration of this matter and will be available to respond to any questions that the Board may have.