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PROJECT NO. ~~37897~~

PUC PROCEEDING RELATED TO RESOURCE AND RESERVE ADEQUACY AND SHORTAGE PRICING	§ § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

NRG ENERGY COMMENTS ON PROPOSED NEW SECTION 25.508,

NRG Energy, Inc. ("NRG") hereby files these comments on the Commission's proposed rule, new Section 25.508, *High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region*, approved for publication on April 12, 2012.[1] These comments represent the broad perspective of several NRG companies, including NRG Texas Power LLC, NRG Power Marketing LLC, Reliant Energy Retail Services, LLC, Green Mountain Energy Company, Everything Energy LLC, US Retailers LLC and Energy Plus Holdings LLC – a variety of substantial market participants in both the wholesale and retail competitive markets in the ERCOT Region.

Resource adequacy is the most important competitive electricity market issue facing the Commission today. NRG applauds the firm leadership and meaningful action the Commission has already provided; measures directed by the Commission and implemented over the last several months have already resulted in positive impacts on the market. A continued focus will be required to establish the regulatory and market clarity needed to achieve the goal of adequate generation investment in the ERCOT market. NRG will continue to work with the Commission, ERCOT, and stakeholders to develop and implement the necessary market adjustments needed to achieve the Commission's objectives.

I. Summary of Comments

- NRG supports increasing the offer cap to $4,500 as soon as possible.
- The Power Balance Penalty Curve should be increased at the same time, and the shaping of the curve should be modified to support proper price formation and to accommodate price response.
- ERCOT credit processes should be adjusted to help mitigate the market impacts.

[1] 37 Texas Register pp. 2955 – 2956 (April 27, 2012); PUCT Docket 37897, "Proposal for Publication of New Section 25.508 as Approved at the April 12, 2012 Open Meeting."

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- Rule language should be clarified to ensure a smooth transition from the offer cap increase in this rulemaking and the possible offer cap increase proposed in Project 40268.
- "Change in law" provisions may be invoked by the new rule for fixed rate retail products; however contracts and market forces will impact whether REPs attempt to pass on such additional costs.

II. Comments

Increasing the System-Wide Offer Cap August 1, 2012.

NRG supports the Commission's proposal to increase the system-wide offer cap ("SWOC") to $4,500 per megawatt-hour and per megawatt per hour beginning August 1, 2012. As NRG urged in earlier comments, the increased SWOC should be implemented as soon as possible. The market needs this early and strong signal to maintain incentives for current supply, incent forward hedging by load serving entities, encourage demand response, and maintain momentum to support new generation development. Each of these outcomes is needed not only for this summer but also to encourage investment in generation and other resources going forward. As the Commission has observed, the competitive market responds the best, and in a sustained manner, when market reforms are ***implemented***. Thus, simply signaling future SWOC increases in future years does not have the same level of positive impact on the market that actual implementation produces. It is imperative the Commission maintain the existing momentum to ensure forward price signals are sustained, market behavior has the right incentives, and potential investors receive reassurance that the Commission will follow through with needed advances in the energy-only market design.

Power Balance Penalty Curve

An increase in the SWOC should also be reflected in an increase to the top value of the Power Balance Penalty Curve ("PBPC"). NRG recommends that, in tandem with this rulemaking, the Commission direct ERCOT to make this adjustment also by August 1. The current PBPC starts at $200 for a 1 MW power balance violation and then increases, non-linearly, to the current SWOC of $3,000 at a 50 MW violation. NRG recommends revising the curve to have a higher starting point of $500 for the first MW violation (to prevent the PBPC from interfering with competitive offers), increasing to $3,000 at a 50 MW violation, and then ramping up linearly to $4,500 from 51 MW to 350 MWs. A PBPC designed along these parameters will result in a more gradual increase in energy pricing as scarcity conditions increase, allowing both generation and loads to respond to the price signals, while providing the potential for an appropriate increase in resources' margins during periods of scarce supply.

ERCOT Credit Issues – critical companion issue.

As the Commissioners have rightly observed, increases in the SWOC will have an impact in the market – in particular, the impact should modify hedging practices among market participants and increase collateral requirements for market participants at the ERCOT ISO. In terms of hedging supply and market positions, NRG believes adequate market tools are available for market participants to manage the incremental change in real-time energy pricing. However, NRG believes the increase in SWOC should be accompanied with modifications to the credit requirements at ERCOT. Efforts to make these changes are underway in the ERCOT stakeholder process in NPRR 459.

Under the current credit-related Protocols, ERCOT can under-collateralize the risks associated with extreme weather events, such as February and August of 2011, and over-collateralize in more "normal" conditions. This is largely because ERCOT calculates posting requirements in part based on the maximum operating day over the previous 60 days, which is not always appropriate. When prices have the potential to be $3,000 or even higher for short periods, a more sophisticated approach is needed to more reasonably calculate legitimate financial risk in the market. In the long term, market models should be used to properly shape collateral requirements to prevent undue impact on market liquidity, while also providing appropriate protection for the market. In the meantime, NRG supports the proposed measures in NPRR 459 that allow ERCOT to exercise reasonable judgment to remove operating days from credit calculations when the use of those operating days is leading to unreasonable results and to make other targeted adjustments in collateral requirements based on expected forward market outcomes.

NRG urges that, in the process of approving the proposed rule, the Commission give direction to ERCOT and stakeholders to implement the modifications proposed in NPRR 459, as finally crafted in the ERCOT process, with an implementation no later than August 1, 2012, if at all possible.

Coordination of SWOC modifications

In Project 40268, *PUC Rulemaking to Amend PUC Subst. R. §25.505, Related to Resource Adequacy in the ERCOT Power Region*, the Commission is proposing modifications to the SWOC in PUCT Subst. R. §25.505(g). The intent of these rulemakings, clearly, is to sync up any changes in the SWOC that may occur in this proceeding with any potential changes made in Project 40268. NRG agrees with Commission Anderson in his memo filed in this Project, May 16, 2012, that if adopted the rule should reflect a smooth transition of SWOC levels that may be determined in these rulemakings. Therefore, in agreement with the Commissioner's suggestion, and consistent with the language approved at the April 12, 2012, Open Meeting, NRG suggests the following modification to proposed §25.508:

> **§25.508. High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region.**
> Notwithstanding §25.505 of this title (relating to Resource Adequacy in the Electric Reliability Council of Texas Region), the high system-wide offer cap shall be $4,500 per megawatt-hour and $4,500 per megawatt per hour beginning on August 1, 2012 and ending on ~~May 31, 2013~~ <u>the effective date of any amendment to the high system-wide offer cap in §25.505 of this title that is effective after the date of this section.</u>

"Change in Law" and fixed-rate retail products.

Question from the Commission:

> *The direct effect of the new section will be to allow resources to offer services in the ERCOT ancillary service auctions at higher prices. In turn, this direct effect is expected to increase revenues to resources, which will be paid for by LSEs, including retail electric providers. Will the new section implicate the provisions of §25.475 that allow retail electric providers to change rates in fixed-rate products for retail customers due to "changes resulting from federal, state or local laws that impose new or modified fees or costs on a REP that are beyond the REP's control?"*

NRG Response:

Yes. The new rule would increase the system-wide offer cap from $3,000 to $4,500 per megawatt-hour beginning on August 1, 2012, until there is a subsequent amendment changing the cap.[2]] The Commission has proposed the change to "ensure that

[2] The first paragraph in the Proposal for Publication indicates that the modified offer cap will terminate on May 31, 2013, although the proposed rule language specifies that it will last until there is a subsequent amendment changing the cap.

the price signals in the ERCOT market are adequate to maintain continuous electric supply for this summer."[3]

In *TXU Generation Co. L.P. v. PUC of Tex.*, 165 S.W.3d 821 (Tex. App. Austin 2005), the Court of Appeals affirmed the Commission's broad authority under PURA to adopt rules affecting price and reliability of both the wholesale and retail markets.[4] The Court held that the Commission has a large degree of latitude in the methods by which it carries out its regulatory functions.[5] The Commission's proposed rule amending the offer cap is one such regulatory action, pursuant to the Commission's authority under PURA to ensure reliability of supply in the wholesale and retail markets.

The Administrative Procedure Act, Section 2001.003(6) (A), describes a Rule to mean "a state agency statement of general applicability that: implements, interprets or prescribes law or policy or describes the procedure or practice requirements of a state agency." The Commission's proposed Subst. R. 25.508 amending the offer cap for a limited time is implementing law and policy. The Commission's proposed rule creates the potential for increased costs to hedge and protect against $4,500 per megawatt-hour prices, or pay wholesale energy costs as high as $4,500 per megawatt-hour. Thus, risk premiums in hedging costs to cover the difference between $3,000 and $4,500 and any wholesale energy costs incurred by REPs between $3,000 and $4,500 are attributable to the Commission's regulatory action. As such, the proposal triggers the pass through provisions in PUCT Substantive R. 25.475.

Notwithstanding the determination that the revised offer cap triggers the rate change provision in §25.475, whether REPs can revise rates in their fixed rate products depends on the language in their customer contracts for large commercial and industrial customers and whether the terms and conditions for small commercial and residential customers contain pass through provisions. However, even if the terms and conditions and contracts allow for a price change due to changes in state law or regulatory actions, the REP is not required to pass through its increase in costs.

The same holds true for variable price and indexed retail electricity products. The revised offer cap would trigger rate change provisions applying to those products. But as with a fixed rate product, it is not required to pass through its increase in costs. Market forces and

[3] See Proposal for Publication; Docket No. 37897 at pg. 1.
[4] Id. at pg 4.
[5] Id.

competitive discipline will ultimately determine whether REPs would actually pass on such costs where they are allowed to do so.

Conclusion

NRG appreciates the opportunity to comment on the Commission's proposed rule and participate in this very important policy proceeding. As the Commission provides its guidance in this proceeding, and as other parties provide their positions and suggestions, NRG reserves the right to refine and modify its positions herein and to take positions on other issues not addressed in these comments. NRG also commits to support continued efforts of the Commission regarding ERCOT resource adequacy - additional measures will likely be necessary to achieve sustainable power supply in ERCOT.

Respectfully submitted,

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