



Control Number: 40000



Item Number: 181

Addendum StartPage: 0



PROJECT NO. 40268

PUC RULEMANKING TO AMEND §  
PUC SUBST. R. 25.505, RELATING TO §  
RESOURCE ADEQUACY IN THE §  
ELECTRIC RELIABILITY COUNCIL §  
OF TEXAS POWER REGION §

PUBLIC UTILITY COMMISSION  
OF TEXAS

RECEIVED  
12 JUN 14 AM 10:56  
PUBLIC UTILITY COMMISSION  
FILING CLERK

**COMMENTS OF BLUE & SILVER ENERGY CONSULTING, LLC  
d/b/a PRO-STAR ENERGY SERVICES**

Comes now Blue & Silver Energy Consulting, LLC d/b/a Pro-Star Energy Services (Pro-Star), a licensed aggregator in the Electric Reliability Council of Texas (ERCOT) region, and files these comments in the above referenced docket in response to the proposal by the Public Utility Commission of Texas (PUCT) for amendments to Section 25.505 of the Substantive Rules.

**INCORPORATION OF PREVIOUS COMMENTS**

Pro-Star previously filed comments in Project # 37897 and hereby incorporates those comments. Specifically, Pro-Star continues to urge the PUCT to make it clear that whether or not a change to the System Wide Offer Cap (SWOC) is a change in law as contemplated by the Substantive Rules or contractual language, this does not give retailers *carte blanche* to pass through any increases they incur as a result of the increase in the SWOC.

**RESPONSE TO ISSUES RAISED BY THE BRATTLE REPORT**

Pro-Star understands that the resource adequacy challenge facing the PUCT and all stakeholders in ERCOT pits the competing interests of generators to make sufficient returns on their investment against the general public desire for low cost electricity. Therefore, it is up to all interested stakeholders to work cooperatively to strike the appropriate balance as both higher energy costs and unreliable electricity supply will damage the Texas economy.

*Observations on current market conditions*

181



Pro-Star notes that the Brattle Report confirms the point made in Pro-Star's comments in Docket 37897, specifically that low natural gas prices rather than any flaw in the market design, are a major reason for the falling reserve margin. As the Brattle Group report states, "the price of natural gas strongly affects the market-clearing price for electricity."<sup>1</sup> In addition, when gas prices were significantly higher than they are in the current market (e.g., 2002-2008, when prices averaged around \$6/MMBtu), sufficient capacity was added to the systems to meet load growth as well as maintain sufficient reserve margins.<sup>2</sup> The fact that natural gas prices are expected to remain low for the foreseeable future means that the resource adequacy challenge faced by the ERCOT is unlikely to diminish, requiring a well-thought out plan for the future with complete buy-in from regulators, politicians and stakeholders as regulatory certainty will be a critical component of the solution to the challenge. Pro-Star believes that the Brattle Report brings in to clear focus that the challenge currently facing the market is not one which can be resolved with a single silver bullet, but will require a multi-pronged solution.

### ***Key points from The Brattle Report***

In contemplating how to best meet the resource adequacy needs of ERCOT for the coming years, Pro-Star believes that there are some areas of the Brattle Report which are particularly pertinent.

#### **The Need for Regulatory Certainty**

First, as the PUCT and stakeholders move forward, a key component to success will be regulatory certainty. As the Brattle Report states, "Investors have to trust that not only the current regulators, but also future regulators will not intervene in a way that undermines their

---

<sup>1</sup> *ERCOT Investment Incentives and Resource Adequacy*, The Brattle Group, June 1, 2012, at 17 (hereinafter Brattle Report).

<sup>2</sup> *Id.* at 17.



investment.”<sup>3</sup> This is especially true given that power plant investors need more than two or three years (the current time horizon for a majority of power contracts in ERCOT) to support investment in generation units which take that long to be put in to operation and have a useful life measured in decades.<sup>4</sup> While Pro-Star recognizes that the PUCT can commit neither future commissions nor the Texas Legislature to any particular course of action, the need for regulatory certainty should be addressed.<sup>5</sup>

#### What is the Appropriate Reserve Margin and Approach?

A second key point from the Brattle Report involves the appropriate reserve margin targets going forward. The current price caps are unlikely to encourage new generation development, especially in the face of sustained low natural gas prices, meaning that resource adequacy is likely to persist as an issue.<sup>6</sup> The report notes that even if the cap is raised as is being currently contemplated by the PUCT, this will not achieve the current target reserve margin of 13.75%, which is designed to produce a loss of load event (LOLE) of one day in every 10 years.<sup>7</sup> One question brought in to sharp focus by The Brattle Report is whether the current standard is the right one. Pro-Star looks forward to comments from other interested parties as to whether the 13.75% current reserve target is appropriate or whether it should be revised.

In addition, Pro-Star would urge the PUCT, ERCOT and other stakeholders to contemplate resource adequacy in more localized terms because even if the system as a whole appears to have sufficient generation capacity “this does not necessarily mean that all locations will achieve the reliability target because the system may have: (1) load pockets within which

---

<sup>3</sup> *Id.* at 105.

<sup>4</sup> *Id.* at 53.

<sup>5</sup> *Id.* at 68 “Even if the current Commission signals a firm commitment to letting the market work, it is difficult for them to guarantee that future commission and legislatures would not reduce price caps in response to extreme outcomes.”

<sup>6</sup> See Brattle Report, page 63, suggesting that current cap levels will yield a reserve margin of just over 6%.

<sup>7</sup> See, e.g., *Id.* at 71.



there is insufficient local generation or import capability to meet peak demands; or (2) generation pockets with excess supply but insufficient export capability to meet peak demands in other locations.”<sup>8</sup> To better address these localized reliability concerns, Pro-Star agrees with the recommendation in the Brattle Report that reliability be assessed on a more localized basis than is currently done through the nodal market. However, the question of how best to do this probably needs to be done in a separate proceeding.

#### Maximizing the Value of the T&D System

A third key point from the Brattle Report is the impact of failures in the transmission and distribution system and the loss of load that results from such failure. Pro-Star is uniquely positioned to provide insight on this particular topic since we deal with end-users on a daily basis and so we know when there are problems with the transmission and distribution system. In fact, the Brattle Report finds that the transmission and distribution related outages have a greater impact on customer reliability than resource adequacy.<sup>9</sup> Looked at another way, the Brattle report suggests that the most cost-effective way to reduce the impact of loss of load events (a/k/a blackouts) on the economic productivity of customers in the ERCOT region is to strengthen the transmission and distribution system. Essentially, this is a way to maximize the value of the assets that are already in the ground, which, according to the Brattle Report, are not being used to their greatest efficiency. Recognizing that this will not solve the resource adequacy problem during the summer peaking months, strengthening infrastructure will reduce the negative impact of loss of load throughout the course of the entire year, although such a build out will come with a cost in terms of higher transmission and distribution rates. The higher rates would need to be evaluated against the benefit from more reliable power to determine whether this is beneficial for

---

<sup>8</sup> Brattle Report at 84.

<sup>9</sup> Brattle Report at 102.



end users. Therefore, Pro-Star respectfully suggests that the PUCT consider taking action to improve infrastructure as part of its goal to insure that power supplies are available to all consumers in the ERCOT region.

#### Reaction to the Proposed Solutions in the Brattle Report

The Brattle Report lays out several options for the PUCT and stakeholders to consider in addressing the reliability needs of the ERCOT market. Pro-Star believes that encouraging demand response in the market place is a positive goal and will be the cheapest way to increase the existing reserve margin and applauds the steps taken by the PUCT and stakeholders to increase DR participation in the market. However, the Brattle Report's recommendation for the PUCT to consider implementation of a capacity market is concerning to Pro-Star and is suggesting that Pro-Star believes would ultimately undermine the market by unnecessarily increasing costs for consumers and interfering with market efficiencies. As the Brattle Report notes, when there is sufficient demand response in the market place "market determined reliability levels have a clear advantage over administratively-determined (capacity markets) reliability outcomes."<sup>10</sup>

Pro-Star personnel were highly involved in the design, implementation, and state regulatory acceptance of the capacity markets in PJM and so have a unique perspective on the impact that capacity markets can have. While the Brattle Report devotes noticeable time and effort to dispelling myths around the perceived drawbacks of a centralized capacity market like that in PJM, this effort ignores an earlier statement in the report that revenues in ERCOT's energy only market were more stable than those in energy and capacity markets.<sup>11</sup> Unlike other organized wholesale power markets which have one or more deregulated retail environments,

---

<sup>10</sup> *Id.* at 103.

<sup>11</sup> *Id.* at 2.



ERCOT has never had a capacity construct and has not had reliability problems until the recent plunge in natural gas prices. In addition, if the PUCT were to consider implementing a centralized capacity market, it would confront a slippery slope problem, as the Brattle Report observes that a “number of PJM suppliers proposed to extend the forward period of the capacity market, or extend the capacity market into long-term products reminiscent of long-term PPAs or a *regulated planning construct* (emphasis added).”<sup>12</sup> In short, the addition of a capacity market in ERCOT would be antithetical to the fundamental market design and increase regulatory uncertainty, without the guarantee of any additional resources being built.

#### **RESPONSES TO QUESTIONS POSED BY THE PUCT**

In its Proposal for Publication, the PUCT asked 4 specific questions relating to the proposed amendment to §25.505 of the Substantive Rules. Following are Pro-Star’s responses to those questions.

**QUESTION 1:** Should the sequence of changing the high system wide offer cap (HCAP) increase at a different rate and over a different period? For example, are any of the following cases preferable to that proposed in the rule? Whatever is ultimately determined to be the appropriate HCAP, should the increase be in one or two steps rather than three or four? Should the specific year for each increase or the specific date of June 1 for the increase each year be changed? If so, what should be the effective date of each change?

#### **PRO-STAR COMMENTS:**

Pro-Star believes that the Proposed Rule, which would raise the cap to \$9,000/MWH by 2015 is a component of solving the resource adequacy challenge facing ERCOT, recognizing that, according to the Brattle Report, even this tripling of the offer cap will not meet the current planning target of a loss of load event once every 10 years.<sup>13</sup> The fact that this action alone will

---

<sup>12</sup> Brattle Report at 44.

<sup>13</sup> *Id.* at 64.



not insure reliability is consistent with Pro-Star's position that this challenge will require a multi-pronged approach.

One change that Pro-Star recommends is setting the start date of any increase in the offer cap to July 1<sup>st</sup> instead of June 1<sup>st</sup>. The reason for this is that summer strip in the energy trading markets is defined as the July-August time frame rather than June-September, which is the time period used for determining the 4 coincident peaks for setting transmission and distribution rates in ERCOT. Pro-Star believes that this change will better match the change in price caps with how power is traded in the wholesale markets. This should reduce concerns about the impact of raising the offer cap on liquidity.

**QUESTION 2:** Is the use of the peaker net margin (PNM) method described in the rule the appropriate mechanism to measure resource adequacy in an energy-only market? If not, what should replace it? Should the PNM trigger amount be the cost of new entry (CONE) or a multiple of the CONE as determined by ERCOT? Should the trigger causing the system-wide offer cap to be reset to the low system offer cap be based on a calendar year or a rolling 12-month period, or should use of the mechanism be based on hitting the trigger for a single year, or for multiple years? Should variability in the weather be taken into consideration in determining whether the PNM trigger is met?

**PRO-STAR COMMENTS:**

As noted above, Pro-Star is not convinced that the current resource adequacy approach is the right one in that it is not location specific and does not necessarily meet the 1-in-10 LOLE standard. Without concluding whether the PNM is the right measure, Pro-Star believes that setting the PNM to a multiple of the CONE will foster a climate this is conducive to additional generation being built in ERCOT. As the Brattle Report notes, "it makes sense to set the PNM threshold as some multiple of the cost of building a new peaking plant, in order to relate to the overall investment returns suppliers may expect to earn."<sup>14</sup>

---

<sup>14</sup> Brattle Report at 82.



In addition, Pro-Star believes that triggering a move to the low system offer cap should be based on a multi-year period. The reasoning behind this approach is two-fold. First, a single year approach increases the likelihood that the mechanism will be triggered and that will depress prices, creating a disincentive for future investment and increasing the risk that ERCOT will face new or additional resource adequacy issues in the future. Second, a one year test period will exaggerate the effects of weather, which can be extreme as was the case in 2011 when ERCOT experienced both record cold and record heat. By shifting to a longer term approach, the impact of weather anomalies is minimized.

**QUESTION 3:** How long would it take market participants to adjust their financial exposure to the proposed amendments? Will these changes affect liquidity in the ERCOT market? If so, how? Will financial counterparties in hedging arrangements continue to be willing to participate and if so at what cost if the HCAP is increased significantly? Would there be any difference if changes were made over a shorter or longer period of time?

**PRO-STAR COMMENTS:**

Pro-Star will leave it to other parties to provide guidance to the PUCT on this question.

**QUESTION 4:** Should the HCAP ultimately go to \$12,000 or \$15,000 and if so over what period of time? If the HCAP is raised to these levels, should the energy from the various ancillary services deployed by ERCOT be priced at the same amount, should there be a slope for the prices for these services, or should ERCOT procure different amounts of these services?

**PRO-STAR COMMENTS:**

Pro-Star does not believe that raising the System Wide Offer Cap to these levels is appropriate at this time. The PUCT and ERCOT have already taken significant steps to address the resource adequacy concerns and as Pro-Star has previously stated, the lack of recent generation investment in ERCOT reflects a broader economic reality, namely exceptionally low natural gas prices rather than any fundamental flaw in the market design in ERCOT. Pro-Star believes that other parties are in a better position to inform the PUCT regarding the treatment of ancillary services.



## CONCLUSION

The PUCT, ERCOT and all the stakeholders have a duty to strike the appropriate balance between insuring reliability and providing low cost electricity for all Texans living in the ERCOT region. The current resource adequacy challenge facing ERCOT is driven by macro-economic factors, specifically the low prices of natural gas, which makes it difficult for generators to earn sufficient returns to justify the investment in new power plants in ERCOT at the present time rather than due to any major market design problem. Pro-Star believes that the actions taken by the PUCT, including consideration of raising the offer cap as proposed in Project 37897 and this Project, are steps in the right direction. Pro-Star stands firm in its belief that an increase in the System Wide Offer Cap, either in Project 37897 or in this Project, does not give retailers the right to pass through higher costs to end-users except in very limited circumstances.

The Brattle Report provides some very useful information for the PUCT and stakeholders to consider as they wrestle with this problem. It highlights the need for regulatory certainty to create an investment climate in which generation can be build new units with minimal concerns about whether they will earn sufficient returns. It also raises the question of whether the current reserve margin standard of 13.75% is the correct one and Pro-Star suggests that reliability needs to be thought about at a granular level rather than just on a system-wide basis. Consistent with the need to look at reliability at a local level, the Brattle Report correctly notes that transmission and distribution system outages are more costly to end users than the occasional loss of load due to resource adequacy concerns and so Pro-Star recommends that the PUCT look at options to strengthen the infrastructure in ERCOT and take appropriate action after weighing the benefits and the cost. Pro-Star further agrees with the Brattle Report that increasing DR participation in



the ERCOT market offers the most cost-effective approach to meeting the immediate and future resource adequacy needs of ERCOT. However, Pro-Star strongly disagrees with the Brattle Report to the extent that it can be construed as urging the implementation of a capacity market in ERCOT as the reliability benefits are likely to be far outweighed by the higher cost and regulatory uncertainty created by a centralized capacity market.

In response to the specific questions posed by the PUCT in this Project, Pro-Star believes that raising the System Wide Offer Cap (SWOC) to \$9,000/MWH is a component of solving the resource adequacy issue in ERCOT, but would urge that the proposed increases in the SWOC be implemented on July 1<sup>st</sup> to match them with wholesale trading practices, which view the summer months as July and August. Setting the peaker net margin (PNM) mechanism at a multiple of the cost of new entry also makes sense and the move to the system wide low offer cap if the PNM is met should be based on a multi-year look rather than a single year look to provide a positive climate for generation investment. However, Pro-Star does not believe that raising the SWOC to either \$12,000 or \$15,000/MWH is appropriate at this time. The impact of recent PUCT actions, including potentially raising the SWOC starting this August and recent protocol changes aimed at increasing reserve margins and creating a good investment climate, have yet to be seen and increasing the SWOC to these levels may not provide any additional benefit. Pro-Star looks forward to the comments of other parties in this Project.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Phillip T. Golden", is written over a horizontal line.

Phillip T. Golden  
Director of Market Development and General Counsel  
Pro-Star Energy Services