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**PUC PROJECT NO. 40268**

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| **PUC RULEMAKING TO AMEND PUC SUBST. R. §25.505, RELATING TO RESOURCE ADEQUACY IN THE ELECTRIC RELIABILITY COUNCIL OF TEXAS** | **§ § § §** | **PUBLIC UTILITY COMMISSION OF TEXAS** |

# LOWER COLORADO RIVER AUTHORITY'S COMMENTS ON PROPOSED AMENDMENTS TO PUC SUBST. R. §25.505, RELATING TO RESOURCE ADEQUACY IN THE ERCOT POWER REGION

The Lower Colorado River Authority (LCRA) offers the following comments in Project No. 40268 - *PUC Rulemaking to Amend PUC SUBST. R. §25.505, Relating to Resource Adequacy in the ERCOT Power Region*, relating to the scarcity pricing mechanism and the proposal to increase the high and low system offer caps and the peaker net margin, and to remove outdated portions of the rule.

LCRA shares the concerns about generation resource adequacy expressed by the Public Utility Commission of Texas (PUC), Electric Reliability Council of Texas (ERCOT) and other market participants in the ERCOT region. Projected load in the ERCOT region is growing at a faster pace than existing and planned generation resources. ERCOT projects that the reserve margin will fall below its target of 13.75% by 2014, as described in ERCOT's May 2012 "Report on Capacity, Demand and Reserves in the ERCOT Region." In addition, the Brattle Group report on "ERCOT Investment Incentives and Resource Adequacy," dated June 1, 2012 (Brattle Report) highlights the challenges to new generation resource development in the current market. Electricity prices have been low during the majority of hours due to current low natural gas prices combined with a relatively efficient generation fleet in ERCOT. In this environment, the Brattle Report identifies that generation developers struggle to justify financing new power projects and capital markets are unwilling to make loans for such investment.

This issue is a pressing public policy concern, receiving appropriately high priority consideration and action from the PUC. Thin reserve margins can compromise ERCOT's ability to reliably deliver electric power. LCRA believes that electric consumers and the overall state economy benefit from a reliable and stable generation supply.

In an effort to provide reliable and stable electric services, LCRA and its non-profit corporation, LCRA Transmission Services Corporation, have taken specific actions. On April 27, 2012, LCRA broke ground on a project to replace its natural gas-fired Thomas C. Ferguson Power Plant in Horseshoe Bay near Marble Falls. The project involves the construction of an approximately 540-megawatt (MW), natural gas combined-cycle power plant to replace the aging 420-MW natural gas fired steam unit, which was built in 1974. The new plant will be more efficient, more reliable and it will have the latest environmental controls. The project schedule includes a two-year construction phase to bring the new power plant on-line in 2014. 182
Further, in the decade since its creation in 2002, LCRA Transmission Services Corporation

invested significant capital in improving the reliability and expanding the capacity of its transmission system in ERCOT. The reliability of the bulk power delivery system is an important consideration since key elements of the grid must be online during times of generation resource scarcity for ERCOT to deliver reliable power.

With long-term agreements in place to provide wholesale power to municipal utilities and electric cooperatives in ERCOT, LCRA can address impacts of the proposed rule changes from the perspective of both generators and load serving entities. LCRA is concerned that increases to the system wide offer caps of the magnitude contemplated in this proposed rule may result in increases of costs to load and may impact generators' credit exposure.

LCRA does not propose particular levels for the system wide offer caps or the peaker net margin. Rather, LCRA recommends a cautious approach that will allow the Commissioners and market participants to observe the results from Project No. 37897 - *PUC Proceeding Relating to Resource and Reserve Adequacy and Shortage Pricing.* Proposed new rule §25.508 would increase the high system wide offer cap to $4,500 per megawatt-hour beginning August 1, 2012. The LCRA recommended approach allows all parties to study the impacts on day-ahead and real-time market prices and collateral requirements. The outcomes of raising the system wide offer caps on generation investment decisions and reserve margins are uncertain, as highlighted in the Brattle Report. Adopting proposed new rule §25.508 and studying the results may help to resolve some of this uncertainty.

LCRA has particular interest in one of the concepts suggested in the Brattle Report and believes it should be explored further. LCRA is interested in the implementation of a gradual scarcity pricing curve from $500 when first depleting operating reserves then increasing to a higher price when close to shedding load. LCRA is not certain how this approach would be administered or whether market behavior will be any different; however, LCRA agrees with the intent of this concept of a more gradual approach to price increases between the point at which reserves are first deployed and the onset of a scarcity event.

LCRA is concerned that increasing the system wide offer caps at the levels proposed in the rulemaking may lead to increased costs for most market participants due to excessive price volatility and risk in the market. Prices could increase rapidly and unpredictably and could result in increased costs to load serving entities if it has committed generation resources that are subsequently on outage or de-rated, as was the case during the extreme weather events of 2011. A high system wide offer cap at three times its current level would have increased this exposure to even greater levels. Also, LCRA is concerned that resources may consider it too risky to participate in the Day Ahead Market (DAM) or ask for a high premium in the DAM to compensate for the risk of experiencing a forced outage in real-time that would expose them to what could be very high real-time prices.

The proposed increases to the system wide offer caps are likely to cause increases in collateral requirements. Higher prices and market participants' increased exposure will increase ERCOT credit utilization and the potential for market participants to exhaust their credit capacity. As a result, entities will likely need to secure additional credit, and incur the additional related cost, in order to mitigate the potential for being credit short and excluded from conducting ERCOT market activities.

Finally, LCRA is concerned about the risk of market participant default and potential uplift of associated costs. Higher prices resulting from raising the system wide offer caps could increase the potential for incurring costs from payment defaults by other market participants. With collateral requirements likely to increase, it will be more difficult for smaller entities to participate in the market.

LCRA supports the PUC's actions to address resource adequacy issues and will continue to work with the PUC, ERCOT and market participants to find appropriate approaches to encourage investment in new generation in ERCOT. LCRA advocates an approach to determine the impacts of Project No. 37897 while the Commission and market participates further evaluate the Brattle Report's suggestions.

Respectfully submitted,

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