Control Number: 40000

Item Number: 187

Addendum StartPage: 0

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 (ERCOT) POWER REGION	§ § § § § §	**BEFORE THE** **PUBLIC UTILITY COMMISSION** **OF TEXAS**

COMMENTS OF THE STEERING COMMITTEE OF CITIES SERVED BY ONCOR

The Steering Committee of Cities Served by Oncor and the Texas Coalition for Affordable Power (collectively, "Cities") appreciates the Public Utility Commission's ("PUC" or "Commission") request for comments on the proposed amendments to P.U.C. SUBST. R. 25.505, relating to Resource Adequacy in the Electric Reliability Council of Texas ("ERCOT") Power Region. Cities appreciate the seriousness with which the Commission has addressed the question of resource adequacy to date, and emphasize that both the reliability and the cost of electric supply are critical issues to municipalities. Any increase to the High System-Wide Offer Cap ("HCAP") can fairly be expected to increase wholesale prices – otherwise, this proceeding has no point – and the resulting increased revenue to generators must be obtained from somewhere. As the Commission is aware, the ultimate place from which any additional revenues to generators must derive is customers.

In the following pages, Cities submit comments on the proposed rule for publication approved at the April 12, 2012 Open Meeting, but first discuss how the recent report by The Brattle Group should inform the consideration of the issues posed by this project.

I. THE BRATTLE GROUP REPORT

In response to the Commission's and ERCOT's direction, on June 1, 2012, The Brattle Group ("Brattle") issued its report on "ERCOT Investment Incentives and Resource Adequacy." The report is a wide-ranging assessment of the state of the current wholesale market, and a

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consideration of a number of policy options that Brattle believes the Commission may wish to undertake. The report is thorough, and complex, and addresses issues and policy recommendations beyond the scope of this proceeding. In particular, the report discusses five potential policy options, ranging from the current energy-only market design to a full centralized forward capacity market, with market designs with increasing capacity commitment components between these two ends of Brattle's policy spectrum. At this time, Cities express no opinion on those options. Other than the option to continue with the current market construct, the large-scale policy choices outlined by Brattle exceed the scope of the rule proposed in this project. Cities therefore believe it appropriate, as the Commission has done, to open a separate project to consider the larger market policy questions raised by the Brattle Report.[1] However, the report does contain some discussion that bears on the merits of the proposed amendments to P.U.C. SUBST. R. 25.505.

A. The Brattle Group recommends deliberate, careful action supported by data and analysis.

The basic recommendation of The Brattle Group is one of caution and deliberation; in the words of the report, its ***primary*** recommendation is that the Commission and ERCOT "evaluate and define resource adequacy objectives" for our grid, and then "choose a policy path to meet those objectives."[2] Overarching this recommendation is a caution against "implementing major changes too quickly or without sufficient analytical support or stakeholder consideration."[3] Notably, there has been no analysis of what either the Commission's proposed rule amendment, or any of the Brattle recommendations, would cost load, and by extension, retail consumers in

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1 *Commission Proceeding Regarding the Recommendations Included in The Brattle Report*, Project No. 40480.

2 The Brattle Group Report at 6 (June 1, 2012).

3 *Id.*

the ERCOT market. It is difficult to imagine how proceeding in the absence of this information would constitute "sufficient analytical support" under Brattle's primary recommendation, or how such a path would enable full stakeholder consideration.

The Brattle Report also highlights another dynamic that Cities urge the Commission to keep in mind in considering the proposed rule. As the Commission is aware, 2014 will arrive too soon to realistically expect new capacity to be on-line by then. However, Brattle cites the recent decision by Calpine to expand two combined-cycle plants; these expansions will total 520 MW.[4] Brattle states that it expects similar uprates and expansions to occur before 2014, based on the expectation of high prices resulting from prior market reforms and lower reserve margins.[5] But Brattle makes this observation as well: "[b]ased on generation owners' comments in our interviews, we expect additional low-cost uprates and reactivations to come online before 2014. These owners, however, may be reluctant to announce investment plans while the PUCT is actively considering whether to increase price parameters in response to an expected capacity shortfall."[6] This quite realistic observation means that the Commission should not expect to see public announcements of much additional low-cost capacity while the Commission is considering whether and how to incentivize investment in that capacity. In this way, the Brattle Report strikes another note in support of moving cautiously.

As Cities have emphasized throughout Project No. 37897, increasing offer caps in addition to the market changes that have already been made risks producing an overcorrection in

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4 *Id.* at 53.

5 *Id.* at 53-54.

6 *Id.*

the market, with corresponding price increases that come with little to no benefit.[7] Cities believe that the preferable approach is to evaluate pricing during this summer to determine how the changes that have already been made impact wholesale prices. Once a track record with respect to these changes is established, ERCOT, the Commission, and stakeholders can more accurately determine what action, if any, should be taken next.

B. Brattle's view of the rule proposed in this project.

Beyond its primary recommendation of moving cautiously, Brattle proposes ten specific changes to the current market structure that it believes should be made regardless of whatever larger resource adequacy framework the Commission may decide upon. Of those ten recommendations, eight are beyond the scope of the rule proposed in this project.[8] Only the first and third recommendations – related to increasing the system-wide offer cap under certain conditions and adjusting the Peaker Net Margin threshold – are within the scope of the rule currently under consideration. With respect to the HCAP, Brattle recommends that the Commission:

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[7] *See, e.g., PUC Proceeding Relating to Resource and Reserve Adequacy and Shortage Pricing*, Project No. 37897, Comments on Proposed New §25.508 of the Steering Committee of Cities Served by Oncor and the Texas Coalition for Affordable Power at 5 (May 29, 2012).

[8] Brattle's ten recommendations, summarized on pages 6-7 of the report, are: 1) increase the offer cap to $9,000 or similarly high level during periods of extreme scarcity; 2) institute a new administrative scarcity pricing function that starts at a low level and increases to the cap once actual load shedding begins; 3) increase Peaker Net Margin to approximately $300/kW-year or similar multiple of the cost of new entry and increase the low system-wide offer cap to a level greater than the strike price of most price-responsive load; 4) enact a variety of measures to increase the ability of demand response to participate in price formation; 5) provide for locational scarcity pricing signals when appropriate; 6) avoid mechanisms that trigger scarcity pricing during non-scarcity conditions; 7) address inefficiencies related to unit commitment without over-correcting; 8) clarify offer mitigation rules; 9) revisit provisions to ensure that retail electric providers can cover their positions; and 10) demonstrate regulatory commitment and stability.

> "…increase the offer cap from the current \$3,000 to \$9,000, or a similarly high level consistent with the average value of lost load (VOLL) in ERCOT, but impose this price cap only in extreme scarcity events when load must be shed."[9]

This is not the same change as is currently proposed in this project. According to the proposed rule, the HCAP would rise to \$9,000 per MWh by 2015, presumably for all intervals – not just during extreme scarcity events. Furthermore, The Brattle Group questioned the basis for the proposed \$9,000 per MWh figure. According to the report, "[n]either the current offer cap nor the proposed offer cap increases are based on an analysis of customers' VOLL or an analysis of the price cap needed to sustain investments."[10] Brattle questions, too, whether a cap of \$9,000 (or even higher) would achieve ERCOT's desired reliability target. The report concludes that a \$9,000 per MWh offer cap would lead to a reserve margin of 10%,[11] and that an even higher cap may not lead to a 13.75% reserve margin – according to Brattle, the expected reserve margin shortfall would be reduced at caps higher than \$9,000, "but the magnitude of the shortfall would be uncertain on average and year-to-year."[12] The report also notes that stakeholders expressed to Brattle their concern that caps much higher than \$9,000 per MWh would produce "prohibitively higher credit requirements."[13]

In view of these problems, Brattle suggests several areas of further inquiry. Perhaps most fundamental is the question of what reliability target the Commission and ERCOT should aim for. The Brattle Report highlights a basic paradox of trying to plan for a particular reserve margin target in a deregulated wholesale market: "higher planning reserve margins increase

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9 The Brattle Group Report at 6.

10 *Id.* at 77.

11 *Id.* at 3.

12 *Id.* at 66.

13 *Id.*

reliability but also decrease the frequency of scarcity pricing...[i]n other words, the high reserve margin needed for reliability eliminates the very scarcity that is required for recovering investment costs."[14] Clearly, ERCOT's reserve margin and wholesale pricing are in tension with each other – wholesale prices affect the level of investment that leads to a particular reserve margin, while the size of the reserve margin has an effect on pricing. Given the importance of the reserve margin to both the reliability of service and on wholesale market prices, Brattle properly focuses on the basis for ERCOT's reserve margin target. The Brattle Report suggests a number of additional inquiries on this issue, including:

- Whether 13.75% is the correctly computed target reserve margin; the Brattle Report raises questions of whether this figure correctly accounts for periods of extreme heat, like the summer of 2011.[15]
- Whether the "one-in-ten year" load shedding standard is the proper basis for calculating the targeted reserve margin.[16]
- Whether the one-in-ten year standard is appropriately interpreted in ERCOT – should it mean one load shed event in ten years, or one "outage day" in ten years, or some other interpretation?[17]
- Whether ERCOT should establish a *desired* reserve margin target, as well as a *minimum acceptable* target required to avoid "extremely adverse" consequences under worst-case weather and outage conditions.[18]

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[14] *Id.* at 65.

[15] *Id.* at 3.

[16] *Id.* at 4.

[17] *Id.*

[18] *Id.*

Brattle notes that ERCOT's reliability target could be met with an increase in demand response and the integration of demand response into SCED.[19] Brattle also states, however, that development of that additional demand response is likely to be severed years away.[20]

With Brattle raising significant questions about the goal to be achieved by this rule, Cities believe that declining to adopt the rule is a reasonable course at this time.

II. CITIES' RESPONSE TO COMMISSION QUESTIONS

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 the 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?

The Peaker Net Margin mechanism was never intended by the Commission to be a mechanism to ensure revenue for generators. It was adopted by the Commission in 2006 as a protective mechanism for consumers. The Commission itself explicitly affirmed this when the current resource adequacy rule was adopted in 2006:

> "The rule, as amended, has set the PNM to allow more than twice the annualized fixed costs of a new gas-fired peaking unit..."[21]
>
> ....

[19] *Id.* at 71.

[20] *Id.*

[21] *Rulemaking on Wholesale Electric Market Power and Resource Adequacy in the ERCOT Power Region*, Project No. 31972, Order Adopting Amendment to §25.502, New §25.504, and New §25.505 as Approved at the August 10, 2006, Open Meeting at 73 (Aug. 24, 2006).

> "The commission agrees...that **an important purpose of the LCAP is to prevent excessive transfers of wealth from load to generation during years when reserve margins are thin.**"[22]
>
> ....
>
> "[T]he commission has determined that the proposal by Joint Commenters to raise the PNM to $350,000 per MW would lead to excessive transfers of wealth from load to generation without any additional benefits to the market."[23]

As these excerpts make clear, the current $175,000 per MW PNM threshold, and the low system offer cap ("LCAP") that would result from meeting that threshold, were together understood to be mechanisms for customers' protection. Indeed, higher PNM thresholds were rejected by the Commission because they exposed load to excessive levels of wealth transfer. These basic concerns of the Commission in 2006 are still valid today, and Cities urge that the PNM/LCAP mechanism, or something similar to it, be retained in the rule.

If the Commission views the PNM as a metric for resource adequacy, then it may be time for the triggering event for imposition of the LCAP to be based on CONE. Cities understand that, like PNM, the triggering event should be an explicit, specified multiple of CONE to reflect the fact that power markets provide both lean years and lucrative years for generators. However, Cities urge that if the LCAP is to be triggered based on a multiple of CONE, that the CONE figure be arrived at in a transparent manner either in a PUC project or an ERCOT stakeholder process. For proposes of the rule, however, Cities support a multiplier of two applied to the CONE to calculate the trigger threshold for imposition of the LCAP, similar to the multiplier applied by the Commission in 2006 in reaching the current rule's PNM.

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[22] *Id.* at 121.

[23] *Id.* at 124.

__Question 4:__

Should the HCAP ultimately go to $12,000 or $15,000, and if so over what time period? 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?

No; there is currently no basis for the Commission to mandate the ultimate increase of the HCAP to $12,000 or $15,000. As noted above, Brattle questions whether an HCAP above $9,000 per MWh would result in ERCOT meeting its reserve margin target, and notes that an HCAP above that level raises significant credit issues for market participants. A proposed HCAP at these levels exacerbates the problems highlighted by Cities throughout this project: a lack of information as to how market prices will respond to the recent market design changes, and a lack of information as to how the impact of an HCAP increase of this magnitude will affect customers. Given the serious questions surrounding the move to a $9,000 per MWh HCAP discussed in Section I, above, Cities recommend against increasing the HCAP even further to $12,000 or $15,000.

III. COMMENTS ON PROPOSED AMENDMENTS TO P.U.C. SUBST. R. 25.505

To the extent that the Commission does wish to adopt an increased HCAP in this project, Cities urge that the increase be limited to the scope recommended by the Brattle Report, as outlined above – that is, the HCAP would rise to $9,000 per MWh in periods of extreme scarcity, when load shedding is occurring. That increase would be set against the backdrop of pricing at or near the current $3,000 per MWh offer cap occurring more often, and for longer periods, as a result of the changes to the market that have occurred under the Commission's direction since last summer. Thus, generator revenue would still be increased, while the Commission would be afforded additional time to consider some of the issues posed by the Brattle Report. The risk of "oversteering" would also be minimized by a more limited HCAP increase this summer, while the full import of the recent market design changes and their impact to consumers can be evaluated over the summer peak season.

Dated: June 15, 2012.

Respectfully submitted,

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