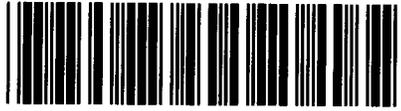


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PROJECT NO. 40480

COMMISSION PROCEEDING
REGARDING POLICY OPTIONS ON
RESOURCE ADEQUACY

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NRG ENERGY COMMENTS ON BRATTLE REPORT AND JULY 27 WORKSHOP

NRG Energy, Inc. (“NRG”) hereby files these comments on the Brattle Group report, *ERCOT Investment Incentives and Resource Adequacy* (“Brattle Report”), as requested in the Commission’s “Notice of Workshop” filed June 27, 2012. 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.

I. Summary of Comments

NRG generally agrees with the analytical approach and conclusions of the Brattle Report; therefore, these comments will focus on what NRG believes are the most important and vital market design elements as they relate to resource adequacy in the ERCOT Region. NRG supports market design changes that will continue to ensure a reliable ERCOT system, while retaining competitive market principles. NRG suggests the Commission consider the following:

- o NRG urges the Commission to give clear guidance to ERCOT and stakeholders on the guiding principles for additional market design modifications in a separate rulemaking (as the Commission did for the nodal market design rule¹) and provide clear deadlines for development and implementation.
- o The energy-only market model is inherently unable to sustain ERCOT’s standard of reliability - additional measures are needed to support long-term power supply investment.

¹ PUCT Subst. R. 25.501, Wholesale Market Design for the Electric Reliability Council of Texas.

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- New market measures must be established that provide support for long-term power supply investments – the focus should be on ensuring competitive outcomes and incentive-aligned market outcomes for resources that support reliability of the grid.

II. Comments

1. ERCOT and the market need clarity, direction, and deadlines to meet the ERCOT resource adequacy challenge.

NRG is committed to actively participating in this Project and to support the Commission in its evaluation of the Brattle recommendations. As a framework, NRG agrees with the Commission's approach to hold workshops for a robust discussion of options and to determine what measures would work best for the ERCOT competitive market. NRG is confident that the Commission can then (or contemporaneously), in the same style as the nodal market rule, quickly complete a rulemaking that: (1) provides guiding principles to ERCOT and stakeholders for the development and implementation of additional market measures, and (2) provides clear deadlines for development and implementation. With this direction, ERCOT and stakeholders can engage in an orderly process to work out the details of the market design and implementation in accordance with the Commission's direction.

2. The Energy-only market model is inherently unable to sustain ERCOT's standard of reliability; additional measures are needed to support long term power supply investment

The current high level of reliable service, for which ERCOT is well-known, is of critical importance to the economy of our state, and a key feature in attracting business to locate, stay, and grow here. ERCOT's supply reliability is a great benefit for economic development in the state of Texas, and is particularly attractive to industries that place a high premium on service quality, such as information technology manufacturers and data centers. NRG believes ERCOT's reliability can be maintained with additional resource adequacy measures that leverage the advantages of competitive market principles.

Brattle finds that a \$9,000 offer cap, without other measures, equates to a 10% reserve margin and could result in more common service interruptions in extreme conditions. Brattle concludes that the Commission must decide if the current high level of reliability remains the goal for ERCOT. If so, high offer caps alone, even much higher than \$9,000, would not be

enough in the long term. Sam Newell, lead author of the Brattle Report, stated in an interview that he did not even attempt to model such elevated offer caps because the level of offer cap needed to meet current ERCOT reliability standards would be so high as to be completely unreasonable.²

The Brattle Report finds that either the reliability objectives of the ERCOT market or the ERCOT market design must to be modified because the current energy-only market will not dependably support the existing ERCOT reliability requirement. The Commission must make a decision to either accept fluctuating reliability associated with an energy-only market, or it must choose to affirm a reliability standard, which will require additional market design changes.³

NRG agrees with this assessment. There is an inherent inconsistency between the current ERCOT reserve margin target and the natural performance and outcomes of supply investment that is dependent upon scarcity pricing. While there was substantial investment early in the ERCOT competitive market, which has allowed a relative grace period in ERCOT's resource adequacy condition, a number of factors have come fully into play that will no longer sustain that investment pattern.⁴ Indeed, Brattle points out that investment in development today is stalled out due to due to "the combination of low gas prices, an efficient fleet, and the recent influx of wind generation."⁵

To support investment, resources must have a reasonable assurance of sufficient scarcity pricing levels and durations to generate adequate revenues. But once the market responds with additional resources, scarcity pricing, and corresponding revenues, will decline precipitously – thus halting new investment; until power supplies are again constrained. ERCOT is then unable to maintain its chosen reserve margin for extended periods (as is the current situation for ERCOT) because new supplies take years to come into service. This "boom and bust" cycle simply cannot sustain a stable reserve requirement and the level of reliability that ERCOT has historically required.

There are additional complicating factors that add more challenges. The investment community is still recovering from the recent recession, and investors are increasingly cautious

² UBS Interview with Sam Newell, lead author of the Brattle Report, June 4, 2012.

³ The Brattle Group, *ERCOT Investment Incentives and Resource Adequacy (June 1, 2012)* ("Brattle Report") pp. 4-7.

⁴ Brattle Report pp. 14 – 23. In addition, as the Commission well knows, many of the investors in generation in ERCOT over the last several years have ended up in financial failure or extreme financial distress, largely driven by the volatility and unpredictability of the energy-only market design – further discouraging generation investment.

⁵ Brattle Report p. 9.

in their development choices – particularly in markets with volatile and uncertain commodity pricing over time. Also, Texas has a robust renewable energy supply and the potential for much more, as the CREZ transmission plan is completed and solar energy becomes more cost competitive and penetrates the market. These intermittent resources create more load and supply variability and downward price pressure (intermittent zero price resource), while creating the need for additional ancillary services and greater operational reserves.⁶

For these and other reasons, NRG urges that the Commission quickly affirm its commitment to maintain the long-term reliability objectives for ERCOT, and not engage in a re-evaluation of this fundamental feature - and instead focus on providing direction for needed, new market measures.

3. Key elements of new market design

The Brattle Group offered several options that could deliver the needed market dynamics to incent additional generation investment, including mandatory load obligations and a forward capacity market.⁷ NRG does not believe the Commission should be unduly constrained by these particular models, but regardless of the direction the Commission moves forward, NRG feels strongly that the following key principles must be included in any new market measures:

- Rely, to the maximum extent feasible, on competitive forces and competitive pressure to set prices, rather than administrative determinations.
- Elicit sufficient investment to meet reliability requirements, without creating incentives or mechanisms that result in significant over-supply or under-supply conditions.
- Recognize the need to meet not only the traditional reliability requirements, but to also ensure reliability in the face of ERCOT's large existing and future renewable energy base.
- Elicit and pay for the types of operable capability that is needed to ensure reliability in light of the reliability challenges.
- Avoid market distorting mechanisms that favor newer capacity over existing capacity.
- Market mechanisms must look far enough forward to allow sufficient time for new projects to be constructed.

⁶ Brattle Report p. 20

⁷ Brattle Report, pp. 112 to 117.

- Consider how markets interact together – how new measures and the energy market work hand in hand to achieve sufficient market returns in a competitive manner.
- Ensure the new measures are well designed to produce efficient outcomes and that will integrate well with existing PUCT rules and ERCOT market rules and processes.

A properly designed market, coupled with the Commission's proposals to increase the SWOC to \$9,000 (which must be accompanied by credit reforms at ERCOT), would still allow the energy market to provide the primary revenue streams required for new resource investment. This structure will allow ERCOT's market design to be primarily based on the economically efficient outcomes provided by energy markets, but reduces the risk of what the Brattle Report described as the potential for "very low reliability." If designed properly, such additional market features can facilitate long-term resource adequacy while preserving a primary role for the energy market in creating the market incentives needed for the private sector to efficiently allocate its resources.

It is also important that, in any market design, existing generation resources must be able to compete on an even basis with new resources, in keeping with competitive market principles. To limit any market enhancement mechanisms only to new resources would be market distorting, increase costs, and could drive premature retirements. As Brattle correctly notes (in the context of capacity market design):

Trying to differentiate either energy or capacity payments based on a unit's age or environmental characteristics would be inconsistent with a market approach in which all resources sell the same product. Paying new generation higher prices would lead to higher costs, for example when new plants are more expensive than retrofitting existing plants.⁸

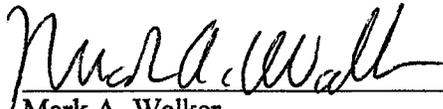
NRG believes that competitive forces will apply pressure to keep market prices in check when paired with a \$9,000 offer cap and related measures (reformed credit requirements and properly shaped administrative pricing curves) because more revenue would be available in the energy portion of the market, thus reducing the amount of "missing money" needed from alternative measures.

⁸ Brattle Group Report, p. 116.

Conclusion

NRG appreciates the opportunity to provide these comments in this very important policy proceeding. As the Commission provides its guidance, 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, as additional measures will likely be necessary to achieve long-term sustainable power supply in ERCOT.

Respectfully submitted,



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