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PROJECT NO. 40000

PROCEEDING TO ENSURE RESOURCE ADEQUACY IN TEXAS	§ § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

SUPPLEMENTAL COMMENTS OF

GSO CAPITAL PARTNERS LP AND STONE LION CAPITAL PARTNERS L.P.

Following their participation in the Commission's July 27, 2012 Workshop concerning *Commission Proceeding Regarding Policy Options on Resource Adequacy* ("July 27 Workshop") and after a review of comments submitted by other parties in Project No. 40480, GSO Capital Partners LP, and Stone Lion Capital Partners L.P. (collectively the "Commenters") hereby seek leave to submit brief, supplemental comments for the Commission's consideration.[1]

Several parties, including the Commenters, in response to the Commission's June 27, 2012 request, filed comments in Project No. 40480 on the recommendations set forth in the Brattle Group Report. Certain parties, including Brazos Electric Power Cooperative, Inc. ("Brazos") and Golden Spread Electric Cooperative, Inc. ("Golden Spread"), offered support for the consideration of rules leading to the design and implementation of a mandatory resource adequacy requirement for load serving entities ("LSEs"), primarily in the form of the Brattle Group Report's Option 4. The Commenters agree with many of the points addressed in these comments, and submit that the Commission should consider steps to further evaluate and potentially implement a market design structure largely in the form of the Brattle Group's Option

[1] The Commenters are comprised of debt investors that hold and or contemplate making debt investments in generation capacity in ERCOT.

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4.[2] Implementing market enhancements similar to those described in Option 4 would help to establish a clear signal of the level of resources needed to ensure reliability and to provide a market-based and competitive approach to facilitate achieving an adequate reserve margin.

A fundamental issue is that ERCOT's energy-only market design does not sufficiently incent construction of new generating capacity, as the energy-only market does not provide a stable, predictable source of revenue necessary to obtain construction and permanent debt financing at reasonable cost. As Golden Spread's filing indicates: "A bilateral ERCOT Resource Adequacy market design incorporating monthly resource adequacy compliance periods would allow the most flexibility for providing incentives to secure long-term financing to develop additional generation resources that can be dispatched in the ERCOT market. Additionally, a monthly compliance program would allow ERCOT the flexibility to manage reserve margin targets through different generation and load situations. Analysis by ERCOT may result in different reserve margin levels during different times of the year." The Commenters believe that this last point suggesting different reserve margin levels at different times of the year is critical as ERCOT's peak weather-driven demand should lead to varying resource adequacy prices on a monthly basis thereby incentivizing the construction of flexible and reliable generating capacity to meet peak loads.

As set forth in the Brattle Group Report, Option 4 contemplates the assignment of resource adequacy requirements to LSEs, including locational minimums for LSEs in load pockets. The applicable resource adequacy requirements would be determined administratively, however LSEs would be required to purchase or self-supply capacity through market

[2] Brazos also filed comments in Project No. 40268 regarding the Brattle Group Report's five distinct policy options for long-term resource adequacy. Brazos comments in that proceeding also support implementation of the market enhancements described in Option 4.

mechanisms sufficient to meet their peak load plus the required reserve margin or incur a penalty. As summarized in the Brattle Report, "ERCOT could facilitate an efficient bilateral market for capacity by qualifying resources into a standard, tradable resource adequacy product." Critical to the success of this market construct however, is the publication and dissemination of resource adequacy clearing prices to all market participants. This will provide an open, transparent and clear signal to developers and financiers regarding the economics of building new generation.

The Commenters also believe that under any resource adequacy construct, all generating resources (including demand response ("DR") resources) cannot and should not be treated equally. For example, renewable resources and DR resources do not have the same reliability and flexibility to meet required demand. Recognizing and reflecting the characteristics specific to these resources (as ERCOT currently does in its semi-annual Report on Capacity, Demand and Reserves in the ERCOT Region) in resource adequacy prices will be an important market design consideration.

Like other parties, the Commenters believe that implementation of this construct (whether such requirements are mandatory or target-based) can be accomplished quickly, as it doesn't necessitate radical changes to ERCOT's current market design. This construct would provide a much needed incentive for developers of new generating capacity in Texas.

If set appropriately, a resource adequacy requirement for LSEs would function to establish long-term market prices among market participants and provide the necessary economic incentives for LSEs to procure adequate resources, thereby supporting the ability to finance future generation capacity and providing the revenues needed to sustain existing and new generation. The resource adequacy requirement, which would be established based on reliability studies, must be high enough such that instead of potentially paying a penalty, an LSE would be motivated to procure capacity in a competitive bidding process among existing and new generation resources. The Commenters also see value in potentially tying the penalty calculation to the market clearing price of energy instead of the cost of new entry, as described in Option 4 (*e.g.*, 1.5 times the market clearing price). Any penalty must be significant enough to ensure that LSE's are appropriately incented to procure sufficient generating resources and should drive resource adequacy prices higher in times of scarcity, thereby incentivizing new generating construction.

The Commenters agree with Brazos that implementation of market enhancements similar to those described in Option 4 would also help to avoid several of the problems faced in regions that have adopted centralized capacity market designs. For example, such markets have been established through implementation of complicated rules that even if arguably designed correctly, have led to problematic implementation issues, subversion, potential manipulation of market rules, and protracted litigation. The relative simplicity offered through market enhancements similar to those described in Option 4 could help avoid similar problems, including the potential for market power concerns and the creation of untenable regulatory uncertainty, all of which has had a chilling impact on investment in new capacity in other markets.

As pointed out by both Brazos and Golden Spread, implementation of Option 4 enhancements would not require radical changes to ERCOT's existing market rules. For example, leveraging procedures currently used for ERCOT's existing Renewable Energy Credits ("RECs") program could provide a workable platform (*i.e.*, the purchase and retiring of generation capacity credits by LSEs) for the assignment and tracking of LSE resource adequacy requirements.

Regardless of what option is ultimately selected, the single most important concern that the Commenters believe must be considered by the Commission as the process for designing and implementing market enhancements proceeds, is to avoid any potential for entry by uneconomic or subsidized generation capacity, especially at the expense of existing generation capacity. As previously noted by the Commenters, the use of taxpayer funded entities to contract for new generation capacity remains a significant problem in other markets across the United States. Despite arguably improving resource adequacy in certain regions during the short term, allowing these entities to contract for generation without proper mitigation has a downward impact on capacity prices to the detriment of other, non-subsidized resources. Whatever enhancements this Commission ultimately approves must be designed in a manner that will not provide for market entry by uneconomic generation capacity and will provide a clear, competitive signal to market participants. Otherwise, significant regulatory uncertainty will exist among potential investors that have faced similar issues in other markets.

As parties currently invested in existing Texas generation capacity and a potential source of financing for future generation projects, the Commenters remain eager to engage in additional dialogue with the Commission on the resource adequacy topic. The Commenters also welcome any questions or comments from the Commission regarding the opinions expressed herein or other issues identified by the Commission.

Respectfully Submitted,

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