

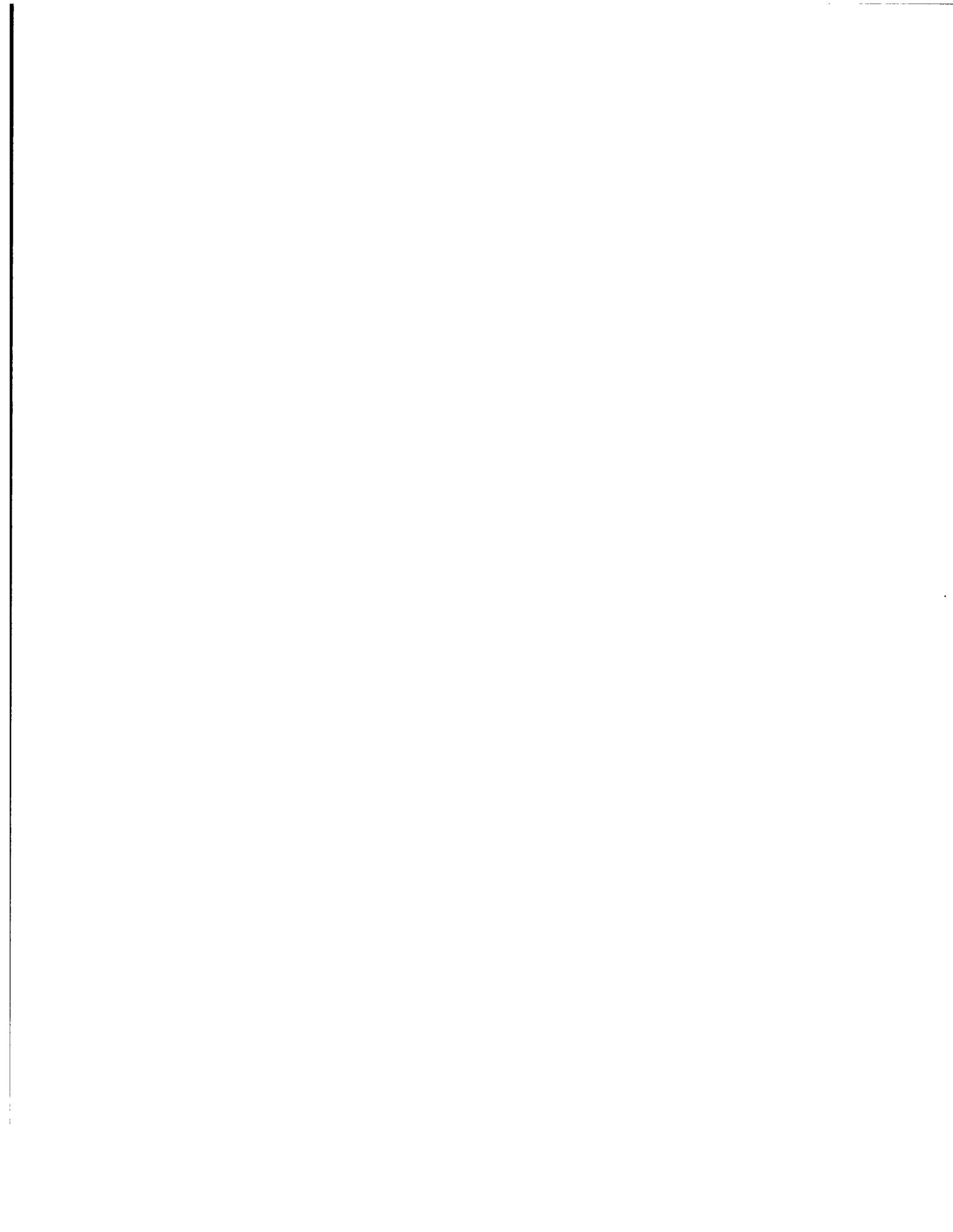


Control Number: 40000



Item Number: 305

Addendum StartPage: 0



# OPEN MEETING COVER SHEET

**MEETING DATE:** September 13, 2012  
**DATE DELIVERED:** September 12, 2012  
**AGENDA ITEM NO.:** 16  
**CAPTION:** Docket No. 40000 – Commission proceeding to Ensure Resource Adequacy in Texas  
**ACTION REQUESTED:** Memo from Commissioner Anderson

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**Memorandum**

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TO: Chairman Donna L. Nelson  
Commissioner Rolando Pablos

FROM: Commissioner Kenneth W. Anderson, Jr. *KWA*

DATE: June 27, 2012

RE: **September 13, 2012, Agenda Item No. 16, Docket No. 40000: Commission proceeding to Ensure Resource Adequacy in Texas**

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Attached are several articles and reports that I think you will find interesting.

I look forward to discussing this issue with you at the open meeting.

## Texas Take Note: Retail Suppliers Say Pass-Throughs of Generation Reliability Charges, "Cause Customer Confusion And Frustration"

September 11, 2012

[Email This Story](#)

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A contractual pass-through by retail electric providers to customers of charges meant to assure the reliability of the electric grid, "cause customer confusion and frustration," a group of retail suppliers have said.

No, these retail suppliers were *not* referring to potential mandated capacity payments in Texas, and the presentation of such capacity costs to customers, but the retail suppliers' comments are instructive of customer reaction to such capacity pass-throughs in ERCOT should any capacity mandate be adopted.

The retail (and wholesale) suppliers filing the above-quoted comment -- Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc., and Exelon Generation Company, LLC and Exelon Energy Company, along with NextEra Energy Services Pennsylvania, LLC and NextEra Energy Power Marketing, LLC -- were actually addressing, in a Pennsylvania PUC proceeding, the treatment of "generation deactivation" costs in PJM, meaning costs associated with reliability must-run (RMR) contracts needed to maintain resource adequacy.

We'll pause here for a moment to let that sink in. In other words, ***notwithstanding over \$50 billion in mandated capacity payments from load to capacity owners***, PJM is still being forced to rely on an increasing number of costly RMR agreements to keep the lights on.

While such RMR contracts no doubt will be characterized as needed due to local transmission issues by capacity market supporters, the transmission issues are prompted by the retirement of *generation*, and PJM's capacity market has a locational requirement, with associated locational premiums, which extract additional payments from loads ostensibly to address any local transmission issues.

The retail suppliers noted that **PJM's deactivation queue has over 14,000 MW of announced deactivations** that PJM is in the process of reviewing. This amount of potential retirements dwarfs the net new steel-in-the-ground capacity procured in the PJM capacity market of **only 6,000 MW since 2007** (e.g. excluding demand response and energy efficiency capacity resources).

"It must be considered that it is not known how many more MW of generation will be added to this [deactivation] list, and exactly how many of these units may continue to operate until appropriate transmission or other reliability upgrades come on-line, potentially resulting in the need for new Generation Deactivation charges to compensate such units in the interim," the retail suppliers said.

Retail suppliers noted that GenOn Power Midwest, LP recently received FERC approval for RMR payments for two PJM units, and that FirstEnergy Generation Corporation is seeking RMR payments for 1,700 MW in PJM.

Load has to wonder what exactly it has received for its \$50 billion in capacity payments.

Whatever other faults may exist with the capacity market, clearly, it is not providing the additional revenues to the "right" generators, meaning those who actually need supplemental revenue outside of the energy market to continue to be available (meanwhile, low-cost assets with a favorable position in the energy bid stack continue to reap infra-marginal revenues from load through mandated capacity

payments even though such generators would continue to be available in the energy market without a capacity payment).

Back to the comments of the Pennsylvania retail suppliers, whose comments were made in exceptions to a recommended decision regarding PECO's default service plan (see prior story) under which generation deactivation charges would continue to be assigned to the load serving supplier (retail supplier or default service supplier as applicable), and thus included in the bypassable generation rate on the generation side of the bill.

The retail suppliers said that, "Generation Deactivation charges are non-market-based, impossible to hedge, and are assessed by PJM to preserve system reliability. The costs represent *administratively determined*, 'surrogate' transmission charges that are temporarily in place until transmission system improvements come on line. The amount of these costs are determined by the PJM Tariff or by FERC in a litigated proceeding and then allocated by PJM" [emphasis added].

"These Generation Deactivation charges are potentially significant in size, and *cannot be hedged because they are not market risks, such as commodity price risk and basis risk*, for which EGSs and wholesale suppliers are appropriately tasked with managing," the retail suppliers added [emphasis added].

The retail suppliers' description of the generation deactivation charges, and the inability to hedge such charges, are largely similar to the issue with any mandated capacity costs. While generators claim that capacity costs may be transparent due to the three-year forward pricing, and the use of an auction to determine pricing, capacity costs cannot be hedged by the vast majority of retail suppliers, due to uncertain future load obligations and migration.

Moreover, Matters would note that while 36 months may be the longest term residential contract generally offered in ERCOT, **five-year contracts are currently offered to Texas customers** (by Just Energy), and, in other retail markets, fixed price contracts **as long as seven years** are now being offered. When retail suppliers are forced to purchase capacity, but only know the capacity charge for three years out, they are precluded from offering fixed price contracts for terms longer than 36 months, unless they have a competitive advantage gifted to them under the capacity market construct.

Indeed, Matters would note that the retail supplier now offering seven-year fixed price electric contracts to residential customers in Ohio and Pennsylvania, FirstEnergy Solutions, owns a large amount of capacity in PJM, and thus has a natural hedge for the capacity cost risk beyond 3 years, through capacity revenues, extracted from competing retail suppliers, earned by its generating units. It is unclear if a retail supplier not owning generating units could offer such a long-term contract, and not because of the supplier's own non-integrated business model, but because of the mandated market rules which require the supplier to pay its competitors for capacity and unknown future capacity charges.

Again turning back to generation deactivation charges at PECO, a recommended decision from a Pennsylvania ALJ finds no issue with the treatment of the charges, and concludes that retail suppliers may simply construct their retail contracts to pass-through future generation deactivation costs to their customers on the generation side of the bill. Accordingly, the draft order would continue to assign cost responsibility for the generation deactivation charges to the customer's generation supplier (either a retail supplier or default service supplier).

In exceptions, the retail suppliers said, "these types of pass-throughs can cause customer confusion and frustration because they are not within the control of an EGS [retail electric generation supplier]."

"Use of these types of contractual 'pass-through' measures can be **disruptive to the EGS-consumer relationship**," the retail suppliers said [emphasis added].

"Use of these contractual measures moreover carries monetary and reputational risk that could potentially drive suppliers out of the Pennsylvania market, in favor of dedicating resources to other jurisdictions in which EGSs would not face the need to invoke such provisions," the retail suppliers added.

"In addition, invoking these types of contractual measures **can damage customers' confidence in the shopping compact that exists between them and their EGSs,**" the retail suppliers said [emphasis added].

Ironically, one of the retail supplier's proposed solutions to the deactivation charge issue (and their preferred solution) is that the Pennsylvania PUC approve the use of a pass-through of the costs to customers -- just that the pass-through is on the distribution side of the bill as a nonbypassable charge, rather than being assigned to the retail generation supplier. Retail suppliers ask that the host distribution company assume all of the cost responsibility for the deactivation charges, rather than such costs being assigned to each customer's specific generation supplier.

Of course, in Texas, this "distribution bill" solution is inapplicable for any pass-throughs. All Texas pass-throughs, such as a capacity pass-through, would come to customers through their retail electric provider, given the nature of the Texas market. While certain delivery charges are handled on a pass-through basis by certain REPs, a mass market customer's contract with their retail electric provider provides for a specific, all-in, rate. By rule, pass-throughs must be included in the EFL-quoted price and, therefore, any change in the amount of the pass-through (as would occur every 12 months when capacity costs change) would disrupt the customer's expected price as listed on the EFL.

While the amount of the Texas customer's all-in rate may change due to legally permissible pass-throughs, it is clear that any such pass-throughs will cause, "customer confusion and frustration" as so ably described by the Pennsylvania retail suppliers. Indeed, Texas customers several years ago were already frustrated with fixed-price contract pass-throughs which prompted a major overhaul in the customer protection rules, and definition of product types, so one can only imagine what the pass-through of billions of dollars of capacity costs will mean for REPs' reputation and esteem, and **customer satisfaction with the competitive market.**

[Link to Retail Suppliers' Comments on Pass-Throughs at PECO](#)

PA PUC Docket: P-2012-2283641

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## Study: Texas Electric Rates Lower Than Rates in States With Capacity Markets

September 12, 2012

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Texas electric rates are lower in nearly all instances than electric rates available to customers in states that rely on "capacity markets" for resource adequacy, according to a review of data conducted by [EnergyChoiceMatters.com](http://EnergyChoiceMatters.com)

"The price for electricity in states with capacity markets shows that Texas businesses and residents are in danger of paying substantially more for electricity if the Public Utility Commission of Texas elects to adopt a capacity market in Texas," said Paul Ring, publisher of [EnergyChoiceMatters.com](http://EnergyChoiceMatters.com)

Link to Capacity Market Price

Study: <http://www.energychoicematters.com/stories/capacitymarketpricecomparison.pdf>

The price analysis, [available for download here](#), compared all-in electric rates for Texas, as published by the U.S. Energy Information Administration (EIA), with rates in states with restructured electric markets that rely on a centralized capacity market. The results showed that residential, commercial, and industrial customers forced to buy capacity through a capacity market pay more for electricity than Texans.

For example, for June 2012, the all-in average Texas residential electric rate was 11.19 cents per kilowatt-hour (kWh). The rate was higher in every restructured state which features a centralized capacity market or capacity mandate, from rates in the 13¢/kWh range in Pennsylvania and Maryland to as high as 18¢/kWh in New York.

Texas' electric rates for commercial and industrial customers are similarly lower than rates in states which exclusively rely on a centralized capacity market for resource adequacy.

"Of course, rates may be higher in capacity market states for a variety of reasons," Ring said. "However, the fact that each and every capacity market state, representing some 14 states, have rates higher than Texas cannot be dismissed as being driven solely by other parts of the electric bill, such as distribution rates or generation mix. When 14 otherwise diverse and independent states all have higher costs than Texas, and share a major market design element such as a capacity market, it's easy to see where customers' money is going."

Although the EIA data may not be perfect, Texas electric rates are lower when comparing actual offers from retail providers as well. For example, in the Oncor service area, a residential customer can find a 12-month fixed rate at a cost of 4.8¢/kWh for commodity energy (referring to 4Change Energy's [Savvy Saver 12 plan](#), excluding transmission and distribution charges in order to make an apples to apples comparison to states where retail providers do not charge for distribution). At Duquesne Light in Pennsylvania (chosen because it is a relatively less congested part of PJM), a utility which is within a capacity market, the lowest 12-month residential fixed offer is 6.39¢/kWh ([from Reliant Energy](#)).

"One back of the envelope calculation [has pegged the potential cost to Texas customers from a capacity market](#) at \$3.6 billion per year," Ring noted.

These billions of dollars in capacity costs would be *in addition to* the current rates paid by Texans for electricity, and why, as [EnergyChoiceMatters.com's analysis shows](#), electric rates are higher in states with capacity markets.

Texas is considering a capacity market, which is an administrative mandate, among several proposals in response to narrow reserve margins and to incent investment in new power plants. Capacity markets are a mechanism used in certain states that mandate that customers pay capacity suppliers, such as power plants, for simply being available to meet demand in the future.

Essentially, under a capacity market, government regulators would mandate how much capacity to buy for future years in order assure reliability, and then would assign costs to each individual customer based on the customer's demand placed on the electric grid. Prices for capacity would be determined by an administrative construct designed to mimic a competitive auction, but whose prices would be heavily influenced by the design choices made by state government officials.

"It's inconceivable that a state and administration which was so fiercely opposed to a federal mandate to buy health insurance is now considering mandating that Texans purchase capacity as a condition of simply being an electric customer," Ring said.

"The Perry administration has called the Affordable Care Act, 'a far-ranging and ever-more-expensive collection of price fixing and individual mandates.' A capacity market, or capacity obligation, isn't much different. As the Texas Industrial Energy Consumers succinctly stated, a capacity market is a 'fictional product ... relying on taxes and penalties to enforce a government-created obligation,'" Ring added.

While a capacity market has been proposed to keep the lights on and maintain Texas' attractive climate for economic development, the higher electric rates paid by businesses in capacity market states should dampen any notion that introducing a capacity market to Texas will make the state attractive to businesses. Indeed, a recent review conducted by EnergyChoiceMatters.com found that none of the top states for business in the United States, as judged by numerous publications, relied on a capacity market.

"In addition to higher rates, a capacity market could also reduce the price-disciplining choice available to Texans when it comes to their electricity provider, as the fixed payments mandated under capacity markets will provide an artificial windfall to certain retail electric providers affiliated with generation, potentially allowing them to assert dominance in the market," Ring concluded.

Link to Capacity Market Price

Study:<http://www.energychoicematters.com/stories/capacitymarketpricecomparison.pdf>

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Capacity Markets and Electric Rates  
A Comparison by EnergyChoiceMatters.com

The following are charts comparing all-in electric rates for various states, developed using data from the U.S. Energy Information Administration, Average Retail Price of Electricity to Ultimate Customers by End-Use Sector, by State, which is based on responses to EIA Form 826.

Three months were chosen for a representative comparison. The most recent monthly data available was chosen (June 2012), as well as two prior but relatively recent months (January 2012 and April 2011), which fall within different capacity delivery years. Using these three months provides a comparison of all-in rates which include capacity prices from three distinct periods.

States were included if they were restructured and were within a Regional Transmission Organization (RTO) which relies on a "centralized" capacity market, including ISO New England, the New York ISO, and PJM Interconnection. California, which mandates a capacity obligation on jurisdictional load-serving entities, was also included, as was Texas, which relies on an energy only market.

Michigan was not included in the comparison due to its utilities' location in the Midwest ISO (which during the relevant period used a "voluntary" capacity auction for resource adequacy), or its utilities' use of a Fixed Resource Requirement to opt-out of the centralized capacity market, for those Michigan utilities within PJM.

Note that Illinois is included in the comparison, but that much of its load is located in the Midwest ISO (MISO), which does not have a centralized capacity market. The MISO voluntary capacity market has generally been characterized by prices well below capacity prices in

centralized capacity market RTOs, and likely leads to Illinois' average electric rates diverging from the higher rates seen in states wholly within an RTO with a centralized capacity market.

Ohio is also included in the survey, but note that during the relevant period, base generation rates were frozen at non-market rates at the majority of the large utilities, namely AEP Ohio, Dayton Power & Light, and Duke Energy Ohio (in the April 2011 data only for Duke), thereby skewing results. Several Ohio utilities also rely on the Fixed Resource Requirement capacity market "opt-out" to meet capacity obligations, which disconnects rates from rates driven by the centralized capacity market.

**Comparison of All-in Residential Retail Electric Rates (¢/kWh)**

**June 2012**

New York	18.30
Connecticut	17.31
New Hampshire	16.54
California	16.09
New Jersey	15.70
Rhode Island	15.32
Massachusetts	14.92
Maine	14.29
Delaware	14.02
Maryland	13.27
District of Columbia	13.17
Pennsylvania	12.97
Ohio*	12.16
Illinois*	11.23
Texas	11.19

*\*See note in introductory summary regarding Ohio and Illinois relying only partially on a centralized capacity market*

**Comparison of All-in Residential Retail Electric Rates (¢/kWh)**

**January 2012**

Connecticut	17.33
New York	16.83
New Hampshire	16.19
New Jersey	16.09
California	15.50
Massachusetts	15.21
Maine	15.21
Rhode Island	14.75
Delaware	13.07
Pennsylvania	12.92
Maryland	12.58
District of Columbia	11.77
Illinois*	11.23
Texas	11.04
Ohio*	10.99

**April 2011**

Connecticut	18.14
New York	17.48
New Hampshire	16.53
New Jersey	16.24
Rhode Island	16.15
Maine	15.35
California	14.60
Massachusetts	14.23
Delaware	13.93
Maryland	13.89
District of Columbia	13.68
Pennsylvania	13.34
Illinois*	11.90
Texas	11.34
Ohio*	11.23

*\*See note in introductory summary regarding Ohio and Illinois relying only partially on a centralized capacity market*

**Comparison of All-in Commercial Retail Electric Rates (¢/kWh)**

**June 2012**

New York	15.94
California	15.51
Connecticut	14.55
Massachusetts	14.35
New Jersey	13.56
New Hampshire	13.45
Rhode Island	12.29
District of Columbia	12.01
Maine	10.76
Maryland	10.76
Delaware	10.14
Ohio*	9.24
Pennsylvania	9.22
Texas	8.28
Illinois*	7.94

**January 2012**

Connecticut	15.02
New York	14.46
Massachusetts	13.82
New Hampshire	13.64
Rhode Island	13.18
New Jersey	12.85
Maine	12.72
District of Columbia	12.32
California	11.96
Maryland	10.80
Delaware	9.78
Ohio*	9.65
Pennsylvania	9.43
Texas	8.54
Illinois*	8.26

*\*See note in introductory summary regarding Ohio and Illinois relying only partially on a centralized capacity market*

**Comparison of All-in Commercial Retail Electric Rates (¢/kWh)**

**April 2011**

Connecticut	15.61
New York	15.04
New Hampshire	13.98
Massachusetts	13.95
District of Columbia	13.14
New Jersey	13.08
Rhode Island	12.72
California	12.68
Maine	12.06
Maryland	11.45
Delaware	10.81
Pennsylvania	10.00
Ohio*	9.80
Texas	8.82
Illinois*	8.65

*\*See note in introductory summary regarding Ohio and Illinois relying only partially on a centralized capacity market*

**Comparison of All-in Industrial Retail Electric Rates (¢/kWh)**

**June 2012**

Massachusetts	14.03
Connecticut	12.70
New Hampshire	11.73
California	11.48
Rhode Island	11.47
New Jersey	11.07
Delaware	9.05
Maryland	8.02
Maine	7.49
Pennsylvania	7.27
New York	6.99
Ohio*	6.14
Texas	5.80
Illinois*	5.79
District of Columbia	3.71

**January 2012**

Connecticut	13.42
Massachusetts	12.90
New Hampshire	11.75
Rhode Island	10.94
New Jersey	10.64
California	9.83
Maryland	8.27
Maine	8.20
Delaware	8.13
Pennsylvania	7.33
New York	6.97
Illinois*	6.18
Ohio*	6.16
Texas	5.76
District of Columbia	4.64

*\*See note in introductory summary regarding Ohio and Illinois relying only partially on a centralized capacity market*

**Comparison of All-in Industrial Retail Electric Rates (¢/kWh)**

**April 2011**

Connecticut	13.38
Massachusetts	12.71
New Hampshire	12.40
Rhode Island	11.14
New Jersey	11.13
California	10.26
Maryland	9.14
Delaware	8.84
Maine	8.81
Pennsylvania	7.78
New York	7.55
District of Columbia	7.54
Illinois*	6.39
Ohio*	6.03
Texas	5.97

*\*See note in introductory summary regarding Ohio and Illinois relying only partially on a centralized capacity market*

## Top States for Business Do Not Rely on Capacity Markets

July 30, 2012

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The top states for business in the United States -- as judged by numerous publications - do not rely on a capacity market, or other non-rate-regulated capacity obligations, to assure resource adequacy -- something which Texas should keep in mind given its concern with attracting jobs.

PUCT Chairman Donna Nelson, in particular, has emphasized that rolling outages are not an option, and are incompatible with Texas' desire to remain a top destination for businesses.

However, the specific mechanism used to assure resource adequacy, as seen in the eastern RTOs, can carry enormous costs which can drive businesses out of such markets, as industrial and other energy-intensive customers in PJM can attest.

Given Texas' concern with creating a hospitable business climate, Matters lists below several recent rankings of the best states for business. Notably absent from *any* of the three lists below is a state which relies on a capacity market to assure resource adequacy (some states, such as Virginia, have utilities in RTOs with capacity markets, but rely on ratepayer-backed resources for resource adequacy rather than the capacity market).

Matters will note that there are copious different lists of the top states for business, that some might produce different results, and that resource adequacy design is not the sole issue determining the rankings. Nevertheless, the rankings affirm that Texas' current energy-only approach is consistent with its overall attractive business climate and is seen as desirable by business interests. The CNBC and *Business Facilities* lists were chosen, in particular, because they were recently cited by Texas Gov. Rick Perry.

### CNBC Top States for Business 2012

1. Texas
2. Utah
3. Virginia
4. North Carolina
5. North Dakota
6. Nebraska
7. South Dakota
8. Colorado
9. Georgia
10. Wyoming

[Link to Complete CNBC Rankings](#)

## ***Business Facilities 2012 Best Business Climate***

1. Texas
2. Utah
3. Virginia
4. Florida
5. Louisiana
6. Indiana
7. South Carolina
8. Tennessee
9. Georgia
10. Nebraska

[Link to Complete Business Facilities Rankings](#)

## ***Forbes 2011 Best States For Business***

1. Utah
2. Virginia
3. North Carolina
4. North Dakota
5. Colorado
6. Texas
7. Washington
8. Nebraska
9. Oregon
10. Iowa

[Link to Complete Forbes Rankings](#)

Since centralized, forward capacity markets were first proposed, businesses have warned of their negative impacts on economic activity and jobs. From the initial joint protest filed against PJM's Reliability Pricing Model capacity market by the PJM Industrial Customer Coalition, Electricity Consumers Resource Council, Illinois Industrial Energy Consumers, Industrial Energy Consumers of Pennsylvania, Industrial Energy Users of Ohio, West Virginia Energy Users Group, and Portland Cement Association, on October 19, 2005:

"Unnecessarily inflating capacity costs through RPM, particularly without any guarantee of increased reliability, will harm businesses' competitive position when compared to other regions of the country as well as overseas," the joint loads had said. The above-rankings appear to bear out the customers' warnings.

Phillip Oldham of the Texas Industrial Energy Consumers provided insight on why businesses oppose a capacity mandate during Friday's Public Utility Commission of Texas workshop, noting that, contrary to the choice currently provided to customers in

the energy market, a capacity mandate cannot be hedged by load, and cannot be avoided. TIEC members are unanimous in opposing a capacity mandate, Oldham said.

Oldham said that TIEC believes that one of the advantages that Texas has had over the other states that aren't growing is that Texas does not, "engage in [capacity] mandates that create taxes on the consumption of electricity that cannot be hedged, cannot be avoided, [and] that significantly raise the cost of doing business in some of those places."

Oldham noted that since the introduction of a single control area, the market has historically seen dwindling reserves three years out, which Oldham called the, "hallmark of an efficient market," as this forecast deficiency corresponds to the development time for new conventional generation.

"Carrying reserves we don't need, for black swan events, or creating taxes on consumption that cannot be hedged -- those will cause [manufacturing] plants to look elsewhere," Oldham said.

"We are within percentage points of being where we need to be ... and that has been confirmed by certain statements by even generation owners. We are very close to having this in a situation where the signals can be sent to maintain the traditional level of resources that ERCOT has relied on," Oldham said.

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