Control Number: 40000

Item Number: 330

Addendum StartPage: 0

PROJECT NO. 40000

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

CITIGROUP ENERGY INC COMMENTS FOR WORKSHOP

Citigroup Energy Inc. ("CEI") is a Delaware corporation with its principal place of business in Houston, Texas. CEI registered as a power marketer in Texas on July 13, 2005, pursuant to P.U.C. Subst. R. 25.105. CEI is a direct, wholly-owned subsidiary of Citigroup Inc. (Citigroup).

Citigroup is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumer and corporate customers. Citigroup has more than 200 million customer accounts and does business in more than 100 countries. Citigroup was incorporated in 1988 under the laws of the State of Delaware. Citigroup is a bank holding company within the meaning of the U.S. Bank Holding Company Act of 1956 registered with, and subject to examination by, the Board of Governors of the Federal Reserve System. Some of Citigroup's subsidiaries are subject to supervision and examination by their respective federal and state authorities.

I. SUMMARY OF COMMENTS

Fundamentally, CEI continues to not take a position which market design ERCOT must have – an energy only market or a capacity market can both achieve resource adequacy if allowed to send proper price signals. As such, CEI believes that the details and incentive structures of the market design matter more than the broad scope of a particular market construct. Instead of advocating for a particular market design in these comments, CEI will highlight the notable parts of the Brattle 'Composite' Policy Options presentation that can impact market outcomes positively or negatively. Finally, in either market design, it is important to have offer caps that approximate the value of lost load to allow the energy market to function to the greatest extent possible. Therefore CEI encourage the Commission to take action to correct the offer caps before the current

330

rulemaking on the subject expires. Further delay in correcting the offer caps would delay future resource construction and investment. In addition, failure to raise offer caps reduces the revenue that incumbent generators will have to reinvest in Texas. In these comments, CEI will first discuss Brattle's review of an energy-only market in Section II, and then discuss Brattle's review of a centralized forward capacity market in Section III.

II. BRATTLE COMMENTS ON AN ENERGY-ONLY MARKET

CEI continues to believe that a well-designed energy only market can have resource adequacy, just as a well-designed capacity market can. However, in an energy-only market, it is critical that the market be allowed to work. To be clear, CEI makes these recommendations in the context of a Commission decision to have an energy-only market. To this end, CEI requests further consideration of the following points raised by Brattle in their latest report:

1. CEI concurs with Brattle's recommendations to provide extra support to demand response in the near term, but doesn't think that demand response incentives need to become an integrated part of the market design. In the energy-only market, a level playing field is critical to efficient market outcomes because of the "just-in-time" nature of generation investment and a structural bias in the market design (like a load capacity auction) would undermine this.
2. The key issue with demand response development is the offer caps, which must be raised. In an energy-only market, a higher volatility cost (derived from higher offer caps) will drive option pricing. This approach has begun to form the basis for a market-based demand response program. Higher offer caps are ultimately the solution to a functioning energy-only market design. Modifying ancillary services to allow more economic curtailment would also be beneficial, instead of merely reliability curtailments.
3. As a short term measure, TDU programs can serve as a bridge to more economic DR in the market. Funded by re-opening the AMS deployment plans or by temporarily waiving the cost caps for energy efficiency programs, the TDUs

could provide "gift certificates" for interested consumers to purchase in-home devices like programmable thermostats, so long as they met certain standards, such as ZigBee and internet connectivity and the ability to be aggregated by REPs, and were activated by the installer. Consumers could go to brick-and-mortar stores or e-commerce websites to receive the devices at a discount, so that the TDU would never have to enter consumers' homes. The program could be styled in a similar way to the Federal government's rollout of digital-to-analog TV converters to allow more bandwidth to be sold in the spectrum auction.

4. Increasing operating reserves, as suggested by EDF and Suez, is a good idea. Increased operating reserves, offered at certain strike prices, will directly help with price formation and recognizes that ancillary services play more than just a reliability role.
5. CEI concurs with Brattle that the back-stop procurement of generation is unhelpful. ERCOT could be stuck in the position of inadvertently competing with private financing of generation, and the revenue above costs provided by ERCOT could become very complex. Furthermore, at some point, procurement in this fashion could begin to function like ad hoc ratemaking.
6. Brattle's analysis of the costs of an energy-only market vs. the costs of a fully developed capacity market may inadvertently be incomplete. By only analyzing 2011 outcomes, Brattle is unable to show the lower costs in years like 2010 and 2012. Year over year, a capacity market will have higher costs than an energy-only market, but will have lower costs in tight years like 2011. This is by design: a capacity market is *designed* to smooth out revenue requirements over several years.

III. BRATTLE COMMENTS ON A CENTRALIZED FORWARD CAPACITY MARKET

Like a well-designed energy-only market, a well-designed capacity market can deliver resource adequacy. CEI concurs with Commissioner Pablos that while "our energy-only market has not failed us and is not broken," the future is unknown. To the extent that Commission decides to create a Texas capacity market, the details of the market design decisions will play a critical role in capacity market outcomes. For example, the recent ERCOT filing in this docket indicates that the simple changes in methodologies, like the choice of a median or low economic forecast, the reserve margin can change by two to three points. Seemingly minor decisions will play major roles in the actual outcome of a capacity market. For these reasons, it is important that to the extent that the Commission determines to implement a Texas capacity market, it must make decisions on the details on an expedited basis. The construction deadline for a generator to be built by the summer of 2015 is quickly approaching, and investors' abilities to forecast the demand in a future capacity market is limited because information about the market design is hazy. In these comments, CEI will raise additional issues that should be determined in the near term if the Commission decides on a capacity market design.

1. First, CEI continues to recommend a vertical demand curve and a strong MOPR as a pair of policies. A vertical demand curve, instead of a sloped one, will only procure as much capacity as is required to meet the reserve margin. A capacity market with a sloped demand curve will procure more capacity than is necessary to meet the reserve margin criteria, which will dampen energy market outcomes unnecessarily. In parallel with this policy, a strong minimum offer price rule (MOPR) will help with capacity market outcomes, despite less need for one in ERCOT due to its single jurisdiction. A MOPR can protect against unexpected outcomes or reduce the incentive for groups of buyers to attempt to exercise buyer-side market power. The Commission could state that it has an intention to create a MOPR in the future rather than developing it prior to the implementation of the market. Perhaps the "Statement of Principles" proposed by Brattle could include an intention to open a rule on the issue if certain events occur.
2. CEI concurs with Brattle on the importance of a three year forward procurement in the context of a capacity market. CEI would further recommend an indicative, non-binding procurement for years four and five to provide additional price discovery.

3. CEI urges the Commission to quickly determine compliance requirements for generation and load capacity, because failure to meet particular compliance criteria could result in non-payment or reduced payment from the capacity market. Certainty around compliance can ease investor worries about the requirements for existing and new generation.
4. Along these lines, compliance requirements for any future capacity market should be determined in the context of product definition. By clearly defining what a megawatt of capacity is required to provide, compliance requirements can be determined and investors can evaluate and determine their offer prices in the future capacity market. So called "negawatts" from demand response should have a very similar (identical to the greatest extent practical) set of product parameters to a megawatt from a generator. As part of this definition, demand response should be deployed economically, and not by ERCOT as part of a reliability program during emergency operations.
5. The "sticker shock" transition proposals are not helpful to capacity market outcomes. First, as Brattle recognizes, the proposal "is discriminatory and could discourage economic capital expenditures to maintain existing resources," which may be some of the simplest capacity additions available to ERCOT. Secondly, the expiration of this transition could be hotly contested. What capacity qualifies as new? What doesn't? The mere act of considering this proposal could delay new capacity additions as investors delay construction to confirm they receive the full potential value of a capacity market. Finally, this proposal shares some similarities with proposals for the Commission to fund back-stop generation capacity and not pay for existing generation.
6. Finally, CEI raises a few notes that should be considered in a capacity market that haven't yet been raised. First, the Commission should consider how to account for energy from DC ties without jeopardizing Texas' jurisdictional status. Second, ERCOT and the Commission should evaluate whether an additional CFTC exemption would be required for the Texas capacity market.

Finally, the Commission, ERCOT, and stakeholders should consider what comprises "capacity and energy" in the standard physical power contract.

IV. SUMMARY & CONCLUSION

CEI is neutral on whether ERCOT has an energy market or capacity market and believes that either market design can work for Texas, if it is well-considered and designed. For the energy-only market, CEI encourages the Commission to take short term action to increase the quantity of demand response, add more operating reserves, and analyze the costs on a multi-year method. If the Commission determines that a capacity market is the correct market design, then CEI encourages the Commission to consider a vertical demand curve, a minimum offer price rule, to finalize compliance requirements by formalizing what products will be offered into the market, to create parity for demand response and generation in product definitions, and to avoid the transition mechanisms proposed by Brattle. Primarily, CEI reminds the Commission of the cost of regulatory uncertainty around these key issues and urges the Commission to not allow the current rulemaking related to offer caps to expire.

Respectfully submitted,

Eric W. Goff
Director
CITIGROUP ENERGY, INC
2800 Post Oak Blvd., STE 500
Houston, Texas 77057

Eric.Goff@citi.com
512-201-3158