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**DOCKET NO. 40000
PUBLIC UTILITY COMMISSION OF TEXAS**

**COMMISSION PROCEEDING
RELATING TO RESOURCE
ADEQUACY IN THE ERCOT POWER
REGION**

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**THE PUBLIC UTILITY
COMMISSION OF TEXAS**

**COMMENTS OF LS POWER ASSOCIATES, L.P.
REGARDING RESOURCE ADEQUACY AND
THE PUCT REQUEST FOR COMMENTS**

LS Power Associates, L.P. ("LS Power") files these comments in response to the Public Utility Commission of Texas ("PUCT") request for comments dated April 3, 2013.

LS Power is a member of the "LS Power Group", a power generation and transmission group with a proven track record of successful project development, operations management, and commercial execution. The LS Power Group has been involved in the development, construction, and operation of more than 20,000 MW of power generation throughout the United States.

LS Power has also been very involved in Texas and the ERCOT market for many years. One of its affiliates has recently placed into commercial operation an approximately 900 MW coal-fired generation resource while another affiliate is currently constructing approximately 240 pole miles of double-circuit transmission lines as part of the CREZ project. LS Power through its affiliates or its predecessor have also developed or operated approximately an additional 770 MW of generation resources in ERCOT, and another 718 MW located in Texas but in SPP. LS Power continues to view the Texas market as an attractive market to deploy resources for future development efforts.

As an active generation developer in other markets throughout the United States, including markets with separate, organized energy and capacity markets, in addition to being a

single generation resource owner in ERCOT, provides LS Power with a unique perspective to this proceeding.

SUMMARY OF CONCLUSION

LS Power appreciates and commends the efforts of the PUCT to investigate and implement enhancements to the Electric Reliability Council of Texas ("ERCOT") market to provide the necessary market incentives to retain existing generation resources and to develop new generation resources and encourages the PUCT to continue these critical efforts. As has been suggested by other stakeholders and the PUCT, the recent implementation of increased energy offer caps is a good first-step forward in providing the pricing signals necessary to incent new development. However, increasing the offer caps alone is insufficient and, in fact, introduces additional risk to generators and other market participants that is problematic and currently cannot be easily mitigated by certain generation owners. The additional change being reviewed by the PUCT to include an Operating Reserve Demand Curve to price scarcity as resources become scarcer is a positive step forward provided certain principles discussed below are satisfied. The primary principle is that the design of the curve should be such that it allows higher prices to occur more frequently while prices at the offer caps become rare events. In other words, there are more hours at "high prices" and less hours at the highest prices. This principle will help generators avoid catastrophic risks while preserving the incentive to provide reliable service to the market.

BACKGROUND

In response to concerns of decreasing reserve margins in the ERCOT market, the PUCT initiated a proceeding to review potential changes and enhancements to the market to provide sufficient revenues to retain existing generation resources and to incent the development of new generation resources. As a result of this ongoing proceeding and the numerous workshops devoted to reviewing various alternatives, the PUCT has taken several actions in an effort to address the resource adequacy concerns. Specifically, these actions include:

1. Increasing the Energy and Ancillary Service Offer Caps to \$5,000/MWh commencing June 1, 2013 and increasing the cap to 7,000/MWh commencing June 1, 2014, and \$9,000/MWh commencing June 1, 2015;
2. Increasing the amount of Responsive Reserves ("RRS") by shifting 500MWs of Non-Spinning Reserves ("NSRS") into RRS;
3. Establishing floor prices for ancillary services; and
4. Increasing the Peaker Net Margin ("PNM") value and increasing the Lower Offer Cap ("LCAP") if the Peaker Net Margin value is reached.

In addition to the above, the PUCT conducted a workshop in January of this year to review two proposals designed to improve pricing operating reserves in the real time – one proposal was a reserve pricing floor ("Option A") and the other proposal was a demand curve price adder developed by Dr. William Hogan ("Option B").

After subsequent comments and another workshop, the focus is now on the option referred to as the Operating Reserve Demand Curve Option B+, which is an adjustment to Dr. Hogan's original demand curve price adder proposal Option B. The adjustment was to introduce an ancillary service imbalance settlement that makes resources indifferent to the utilization of

their capacity for energy or reserves and addresses the negative market behavior that Option B could incent due to the inconsistency between the increased price and the dispatch from the real-time market. Option B+, along with the increase in offer caps, provide the “missing money”. In preparation for another workshop scheduled for June 27, 2013, the PUCT solicited comments on Option B+ and other market enhancements.

INCREASE IN OFFER CAPS CREATES ADDITIONAL RISK FOR MARKET

PARTICIPANTS

As mentioned above, increasing the offer caps is a good first-step in providing the incentives necessary to encourage a healthy market for all participants large and small (i.e., existing generation, future generations, demand response, etc.) and thereby improve the reliability of the ERCOT system. However, additional market changes will be required to ensure that the increased offer caps do not pose detrimental risk to generators and other market participants. Such outcomes are directly contrary to the PUCT’s objectives. Continuing this evolution in market enhancement will be critical to ensuring that it functions efficiently and generates enough revenue to allow existing and future market participants to make a reasonable profit.

If a market participant is committed to providing resources into the market and is unable to deliver at the time energy prices rise and suddenly “jump” to the offer cap, the penalty to the market participant, including the replacement costs, could be substantial. Such an event could easily wipe out any prior revenues for that market participant. This is of particular concern to owners that do not own a fleet of generators (“limited unit generators”) and other similarly situated market participants who, unlike generator owners with a portfolio of resources, do not

have the capability to absorb the loss across a large number of generation resources that otherwise would be operating and collecting the offer cap price. Without a robust market for hedging this risk, limited unit generators and other similarly situated market participants face what could be a potentially catastrophic event.

This lack of a robust, risk management market compounds the problem for market participants such as limited unit generators because such risk cannot be viably mitigated. Such limited unit generators are left on the hook for market-based mitigation measures. These would include executing certain hedges to protect their position in case of such an event or procuring outage insurance. However, costs associated with implementing such protections are grossly prohibitive and cannot be supported by market fundamentals. Simply stated, for limited unit generators, under the current conditions, purchasing such protection is likely to take away most of the benefits of the market improvements that the PUCT has already implemented and those currently under consideration.

Unable to protect against such events leaves existing generation extremely vulnerable and can provide a chilling effect to new generators looking to enter the market. Developers, like LS Power, unable to hedge against the consequences, will not be willing to take on that risk and will instead look to other markets that do not have this unit-specific risk to deploy their resources and develop new generation projects.

**A PROPERLY DESIGNED SCARCITY PRICING MECHANISM THAT GRADUALLY
INCREASES PRICES OVER TIME AS AVAILABLE RESERVES DECREASE
WITHOUT THE SUDDEN "JUMP" UP TO THE OFFER CAP WOULD REDUCE THIS
RISK**

The concept of increasing operating reserves prices as reserves become scarcer is an appropriate complement to increased offer caps in providing the revenues and pricing signals needed to retain existing generation, incent new development, and encourage the demand response market. Likewise, the use of an operating reserve demand curve to determine those prices is also appropriate. However, as discussed above, if the shape of the curve is improperly designed, the additional risk will still exist, therefore defeating the entire purpose of implementing a scarcity pricing mechanism.

Therefore, it is critical that whatever method is used to price operating reserves, the prices need to increase gradually over time as reserves become scarcer. The object should be to allow higher prices to occur more frequently with spikes to the offer caps to be extremely rare events. This translates into a larger operating reserve holdback which we believe needs to be coupled with a release curve that has a gentle slope. A fair structure that accomplishes the PUCT objectives would allow higher prices to occur more frequently with price spikes to the offer caps continuing to be extremely rare events. This structure would result in a lower risk profile to generators and enable all generators to engage in hedging and other markets. Otherwise, the perceived pricing premium that may become available in the forward markets will not be useful as a hedge to any owner that does not own a large diversified fleet.

THE PUCT SHOULD CONTINUE EFFORTS AT MARKET REFORM

Texas has a strong, growing and vibrant economy. Reliable and competitively priced power is critical to the economy. Although several new projects are under construction, we believe additional generating units will be needed in the coming years. Market reform will be important in providing that incentive. We cannot overlook the fact that low cost financing as a

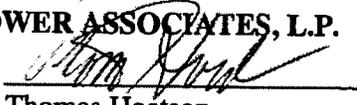
result of low interest rates supported by the Federal Reserve has helped many of these new projects move forward. This low interest policy may change in the future and suddenly so it is critical that we have a well-structured market to keep these projects and other future projects on a sustainable course.

CONCLUSION

LS Power looks forward to continue to work with the PUCT and ERCOT to implement improvements and enhancements to the current market structure, including an effective and attractive operating reserve demand curve that will minimize price spikes to the offer caps and instead provide more frequent gradual price increases. This will provide market participants like LS Power the proper price signals needed to retain existing resources and attract new development.

Respectfully submitted,

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