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Item Number: 443

Addendum StartPage: 0

PROJECT NO. 40000

PROCEEDING TO
ENSURE RESOURCE
ADEQUACY IN TEXAS

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SUPPLEMENTAL COMMENTS OF AUSTIN ENERGY and CPS ENERGY

Austin Energy¹ and CPS Energy² (“The Parties”) file these supplemental comments in *PUC Proceeding to Ensure Resource Adequacy in Texas*, Project No. 40000. The Parties appreciate the opportunity to offer their perspectives on the additional Interim Solution B+ back cast scenarios analyzed by the Electric Reliability Council of Texas (“ERCOT”) and the Brattle Group in their July 23, 2013 filing, as well as comments provided by Potomac Economics (“IMM”) in its July 25, 2013 filing.

The Parties conclude that ERCOT’s analysis of the additional Interim Solution B+ scenarios is prone to the same criticism that the Parties and other stakeholders noted in comments previously filed in this Project. Namely, the analysis does not consider changes to market participant behavior which would arise from the impact of added price volatility and increased credit risks and is based on a concept design that is fundamentally flawed. Failing to include these important adjustments into the analysis calls into question the validity of the results and does not provide the Parties with any certainty that Interim Solution B+ would help ensure resource adequacy of the ERCOT market under any reasonable scenario.

The Brattle Group’s supplemental analysis estimates a wide range of economic equilibrium reserve margins for each of the additional Interim Solution B+ scenarios, reflecting the uncertainty of changes in market behavior that may arise. Brattle qualified its analysis by stating, “The uncertainty in estimates is even larger for these curves than for those that we examined for the June 27th Workshop, because the operational scarcity margins in ERCOT’s Backcasts are much greater and are therefore more sensitive to uncertainty in the market’s response. [...] Such high prices would likely incentivize a market response even greater than the

¹ Austin Energy refers to the City of Austin d/b/a Austin Energy.

² CPS Energy™ is the registered trademark of the City Public Service of San Antonio, acting by and through the City Public Service Board.

level we assumed in our High Market Response Scenario....”³ The caveats contained throughout Brattle’s supplemental analysis indicate to the Parties that the back cast analysis cannot accurately estimate market impacts and resulting reserve margins, or account for unintended, negative consequences caused by the non-market nature of Interim Solution B+.

Additionally, the Parties support the IMM’s July 25, 2013 comments regarding the primary purpose of an operating reserve demand curve.⁴ The indispensable principle underpinning an operating reserve demand curve is that it should set prices of reserves as a function of the probability of loss of load and Value of Lost Load (“VOLL”).⁵ Adherence to this fundamental principle results in a minimum contingency reserve level (“X”) of no greater than 1,375 MW, a generally accepted point at which the probability of involuntary load curtailment becomes real in the ERCOT market. Values of X greater than a level at which firm load shed historically begins serve to administratively add resource revenue to the market, and do not reflect the economic principles and market-driven solutions which have made ERCOT one of the most efficient energy markets in the world.

The Parties also agree with the IMM’s comments with regard to the Value of Non-Market Actions (“VNMA”). It is clear from the IMM’s comments that there is no economic justification for enhancing Interim Solution B+ with another price adder for the actions taken at EEA1, and that Interim Solution B+ with VNMA does not consider the likely changes in market behavior resulting from the implementation of Interim Solution B+.⁶ The VNMA curve appears to systematically over-value non-market actions and does not consider the relationship between the non-market action and the changing probability of loss of load. As with VOLL, VNMA must be determined by economics-based analysis as the inclusion of inaccurately set parameters may unintentionally lead to market-distorting outcomes, including higher credit risk, increased pricing volatility, and decreased investments.

Moreover, the Parties note that ERCOT has not finalized its VOLL calculations, and instead, Interim Solution B+ uses the administratively-determined system-wide high offer cap

³ Comments of ERCOT, *Responses to Commission’s Request for Analyses of Additional ORDC B+ Scenarios*, Project No. 40000 at 15 (July 23, 2013).

⁴ Comments of Potomac Economics, *Comments*, Project No. 40000 at 1 (July 25, 2013).

⁵ See Comments of GDF Suez Energy North America, *Copy of Presentation Given by Professor William W. Hogan*, Project No. 40000 at 13 (July 3, 2013).

⁶ Comments of Potomac Economics, *Comments*, Project No. 40000 at 2 and 3 (July 25, 2013).

("SWCAP") of \$9,000/MWh. Though its study has not yet been completed, London Economics International's ("LEI") estimate of the ERCOT VOLL for commercial and industrial customers ranged from \$5,645 to \$6,468/MWh.⁷ LEI offered no estimate for ERCOT's residential customers, but did estimate that VOLL for residential customers across the entire state would approach \$110/MWh.⁸ These estimates, incomplete as they may be, call into question the use of the \$9,000/MWh SWCAP as a proxy for VOLL. The Parties conclude that reliance on administratively-determined values for X, Lost Load, and Non-Market Actions undermines the ERCOT market by inefficiently adding parameters that should be adjusted to meet changes in market conditions, may cause an investor to perceive increased regulatory risk, and may result in less resource investment.

Finally, the Parties notice that Interim Solution B+ with VNMA is taking the shape of the Brattle Group's Policy Option 2 for achieving resource adequacy. Brattle outlined the "Energy-Only With Adders to Support a Target Reserve Margin" option in its June 1, 2012 report, and noted that it carried a medium risk of low reliability outcomes, had high investor risks, and had low economic efficiency.⁹ The Brattle Group indicated that the main draw of this option is that it would not require a "major market redesign." However, Brattle highlighted a plethora of disadvantages of this approach, including: (1) it does not reliably achieve a target reserve margin; (2) it sets prices at levels that deviate from marginal system costs; (3) it raises the cost of doing business through higher credit and hedging requirements; and (4) it would require raising caps to levels well above VOLL.¹⁰ If for no other reason, Interim Solution B+ should be discarded, and the conversations should return to determining the most efficient, most effective methods for achieving resource adequacy in ERCOT as outlined by the Brattle Group's June 2012 report.

⁷ Comments of ERCOT, *Value of Lost Load Literature Review and Macroeconomic Analysis Prepared for ERCOT by London Economics International LLC*, Project No. 40000 at 66 (June 18, 2013).

⁸ *Id.*

⁹ Comments of ERCOT, *ERCOT's Submission of the Brattle Group's 'ERCOT Investment Incentives and Resource Adequacy' Report* (filed 6/1/2012), Project No. 40000 at 5 (July 24, 2012).

¹⁰ *Id.* at 112 and 113.

Respectfully submitted,

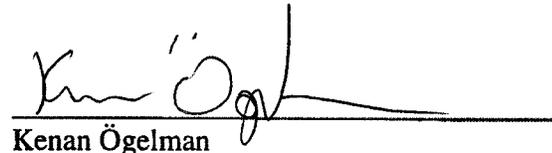
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