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PROJECT NO. 40000

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

INVESTOR COMMENTS

Perry Capital, LLC[1] and CarVal Investors, LLC[2] acting independently of one another but with common purpose with respect to the filing of these comments (referred to herein as Investors), have invested, and continue to invest in, power markets across the United States that support such investment. Investors support the efforts the Public Utility Commission of Texas (the "Commission") is undertaking to evaluate the systemic reasons for the declining reserve margins in the Electric Reliability Council of Texas ("ERCOT") market, beginning with the commissioning of the Brattle Report. The Brattle Report identified the economic disincentives to investment in the energy-only market absent a mandatory reserve margin as well as discussed the market fundamentals that would be required to incent new investment.

Investors have carefully reviewed the economic fundamentals of the ERCOT energy-only market and the manner in which the energy-only market rewards as-available energy, and not capacity. The proper functioning of the energy-only market design has reduced the reserve margin in the ERCOT market from 31% in 2001, to levels that are near or below the current 13.75% standard, and those levels are projected to consistently decline in coming years despite being needed to support the rapidly growing Texas economy. The reason for the lack of

[1] Perry Capital, LLC has approximately $9 billion in total assets under management.
[2] CarVal Investors, LLC has approximately $9 billion in total assets under management.

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investment in the ERCOT market is that the market fundamentals do not support investment in new-build capacity. In fact, based on current forward prices, the cash flows produced by a newly built, efficient gas-fired generating plant in ERCOT would only support approximately half of the plant's total cost. This conclusion is further supported by recent transactions in ERCOT including (1) generation asset purchase/sale transactions between sophisticated parties; (2) brownfield generation capacity additions pursued by large Texas generators; (3) implied stock market valuations for large generators' Texas generation assets; and (4) the financing terms offered by investors to ERCOT power plant developers.

Investors support the comments made by the Texas Reliability Assurance Market Advocates ("TRAM Advocates") in supporting a mandatory reserve margin. An initial decision to establish a mandatory reserve margin will provide a signal to the investment community that the Commission is moving forward with implementing regulatory changes that will address the systemic problem with the energy-only market – that it does not allow investors to receive a return of, much less a return on, invested capital. The Commission can approve a mandatory reserve margin concept, without establishing the level for the mandatory reserve margin, to send this signal. Once the Brattle reserve margin analysis is complete, the reserve margin level can be determined based on updated information and the Brattle results.

A Commission determination that a mandatory reserve margin will be implemented will allow for progress toward the development of the most efficient mechanism to achieve that reserve margin. Investors recognize that there are risks to investing in any market, including merchant energy, and do not seek guaranteed returns. However, an investor must have confidence that market rules will provide for the opportunity to realize the upside in the earnings of a business, in addition to bearing the losses the business may incur. For this reason, the mechanism constructed to achieve the approved level of mandatory reserves must satisfy three fundamental principles: (1) incentives for new-build capacity and the retention of the most efficient existing capacity – whether from generation or demand response – must be competitive, and non-discriminatory, rather than favoring new investment over prior investment; (2) the solution must be market-based and transparent; and (3) the mechanism must provide a reliable forward price signal in order to improve generation investment conditions in Texas. Investors believe that a properly designed forward capacity market is the most efficient mechanism to both achieve mandatory reserve margin requirements and satisfy these fundamental principles.

Investors appreciate the opportunity to provide comments in this proceeding and believe that a Commission determination that sets a mandatory reserve margin for the ERCOT market, with the level of the reserve margin being determined in the near future, is a critical signal to send. It is important that the Commission send this signal while there remains time to resolve the resource adequacy issue through market-based mechanisms, the hallmark of the Texas competitive market.

Respectfully submitted,

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