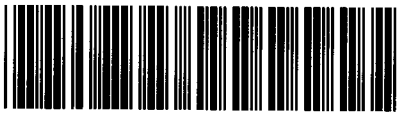

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PROJECT NO. 40000

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

GDF SUEZ ENERGY NORTH AMERICA, INC. RESPONSES TO QUESTIONS FROM COMMISSION QUESTIONS REGARDING RESOURCE ADEQAUACY

I. BACKGROUND

On November 22, 2013, the Public Utility Commission of Texas (the "PUC" or the "Commission) published a Notice of Workshop in this Project for January 29-30, 2014. In preparation for the workshop, the Commission requested written comments from interested parties to questions posed by Chairman Nelson and Commissioner Anderson on October 25 and November 15, 2013, respectively. Consistent with the Notice, the comments of GDF SUEZ Energy North America, Inc. ("GDF SUEZ") below are timely filed.

II. DISCUSSION

GDF SUEZ appreciates the diligent and measured review by the Commission of all of the data and facts on this complex issue prior to making a determination regarding a planning reserve margin requirement in ERCOT. A new approach to demand forecasting and the methodology for determining future capacity needs and availability of the system are being developed. At the same time, the Brattle Group is studying the Economically Optimal Reserve Margin ("EORM") for ERCOT. Once the collective ERCOT and Brattle data is released, it should provide valuable and timely information regarding the optimal least-cost level of future planning reserves needed in ERCOT and a better picture of the immediacy of capacity needs. Therefore, the Commission should wait to make any significant market design changes until this critical information has been made available and digested by policymakers and stakeholders.

GDF SUEZ remains committed to the position that regardless of any current or future market design, proper scarcity pricing is the critical driver to make any competitive market work. Even if the Commission ultimately decides to include a capacity component, the primary driver of revenues in ERCOT should come from energy with capacity providing residual revenues as necessary.

As stakeholders answer detailed questions in this proceeding regarding key components of a potential capacity market construct, it is important not to lose sight of the critical cornerstone for success in either market design – proper scarcity prices. A well-designed capacity market seeks to reflect the scarcity value that would otherwise be reflected in a properly functioning energy market while seeking to avoid scarcity in supply through a required and specific planning reserve margin. In the Regional Transmission Organization ("RTO") markets outside of ERCOT, the need for the capacity market to fulfill this role has been particularly important. For example, as revealed in the Independent System Operator of New York ("ISO-NE") capacity market, procurement of capacity up to its reserve margin has not assured adequate resources when they are needed the most. To address this issue, the ISO-NE is finding it necessary to improve the capacity market performance incentives, particularly in periods of scarcity.[1]

Given this experience, it should be clear that whether through energy-only markets or energy and capacity in combination, there is no substitute for proper scarcity pricing.

If indeed the goal is to establish a more effective market in ERCOT based on best practices from other regions, the market design ultimately approved by the Commission should

[1] Despite having a surplus of installed capacity, New England has experienced situations where the performance of resources presented operating challenges. Examples include a Sept. 2, 2010, NERC violation for failure to restore the system to balance within 15 minutes despite ample quick-start and ramp capability on paper, unavailability of gas units, and low oil inventory at oil units last winter. ISO-NE is now pursuing changes to significantly improve the incentive for capacity resources to perform when the ISO needs them most – during periods of scarcity.

assure that ERCOT has adequate supply that performs when needed most. The design should also appropriately reward dispatchable generation over non-dispatchable generation. Implementing an effective Operating Reserve Demand Curve ("ORDC")[2] as quickly as possible is the first step to that design. Otherwise, ERCOT will not benefit from the important lessons learned in other markets.

A. Specific Responses

Many of the questions posed to stakeholders are interrelated regarding a capacity market construct. GDF SUEZ has answered the questions that address the most critical elements that it believes must be included should the Commission determine that an energy-only construct cannot be designed to meet ERCOT's reliability needs and decides to adopt a capacity market component.

1. What resources should be allowed to participate in the market?

All new and existing units and demand response in Security Constrained Economic Dispatch ("SCED") that can demonstrate, with measurable certainty, that during a summer peak the resource will be available should be allowed to participate. Measured and demonstrated capability should be a requirement on any resource receiving a capacity payment.

2. Should a vertical or sloped-demand curve be adopted?

A capacity demand curve should be sloped. A sloped demand curve for capacity is an administrative mechanism and the decision of the degree of slope will involve significant debate given the trade-offs that can affect the capacity prices and their volatility, amount of capacity cleared, and whether the capacity prices signal a need for investment to meet the reliability standard. The curve should be anchored by a proxy unit's Cost of New Entry ("CONE"). The

[2] GDF SUEZ's recent related filings into Project 40000 including a pending request to increase the VOLL (Items 431, 442, 458, 497, 509).

establishment of the proxy unit CONE is a critical determination with significant impact on the capacity auction clearing price. It should be constructed to avoid volatility in the market. By contrast, a vertical curve involves large fluctuations in price for small increases or decreases in supply when the market is near equilibrium. Based on experiences in other markets, the Commission and ERCOT should allow ample time for a full analysis of this issue and thoughtful resolution of lengthy stakeholder debates.

3. How far forward should the procurement go?

Other organized wholesale markets with capacity constructs use different delivery-year (procurement) periods ranging from one year to three years forward. The commitment periods (or lengths of contract) can vary greatly ranging from monthly or seasonal periods to periods spanning multiple years. The further out in time the delivery year, the more difficult it may be to adjust to changes that may occur affecting capacity costs, such as compliance costs of new environmental rules.

For the ERCOT market, GDF SUEZ would prefer a nearer-term delivery period of one year similar to the construct used in the New York Independent System Operator ("NYISO") market design. This design more accurately aligns supply and demand while allowing for more clarity around near-term operational capabilities. Otherwise, ERCOT would experience a long transition period to implementation of a capacity market. It is likely there will be a potential 2^+ year development period for the rules to establish a subsequent three-year auction. This would create an untenable period of regulatory uncertainty for prices in ERCOT – the opposite of what the market needs. A nearer-term capacity commitment appropriately rewards existing generation owners who have invested in maintenance practices and equipment selection that result in high availability rates in the market.

Regardless of the forward commitment design selected, in all cases, the units participating in capacity auctions need to be permitted, certified, and tested for performance capabilities. In the case of new capacity, strict construction milestones would need to be included to ensure physical commitment and deliverability. This will require significant capacity qualification evaluations and financial assurance requirements.

4. What additional elements of a reliability market design should be considered?

i. Avoid "Payments for Nothing"

Any new capacity market construct should be designed around the concept of defining the performance obligations assumed by sellers, rewarding good performance, and penalizing non-performers. This requires either that all sellers have the same performance obligations or that resources are distinguished by capabilities under some form of "tranching" approach. It should be noted that there are currently no organized RTO markets with a capacity construct that incorporates "tranching" by capabilities.

Well-defined performance obligations – requiring the same of all sellers – with strong performance incentives and strict, enforceable penalties should be established. If high reliability is the goal, then all resources should be approved, registered, and tested for assurance and reliability of deliverability. There should be strict penalties for capacity sellers failing to deliver their resource either during a test or by actual performance failure. There should also be incentives for those who perform as promised and those who "make up" for capacity sellers who do not perform.

Capabilities of the various generation units should be considered when defining the value of any capacity payments. Any capacity market should compensate the capacity based on its value in the market. This can occur one of two ways. One way is through resource

differentiation based on flexibility and capability to meet grid operational needs. Different payment levels are matched to specific operational characteristics and flexibility through a tranching form of procurement with an agreement to the number and size of tranches needed. Alternatively, a one-product market[3] would require that all sellers receiving the same price are subject to the same performance obligation (e.g., energy or operating reserve) where resources under-performing may purchase credits from those that are over-performing.

ii. Avoid "Too Much" Capacity in Planning Reserves

The agreed-to planning reserve margin should be close to the EORM. Excess capacity will only do more harm to the market by diminishing scarcity prices in ERCOT and require consumers to support more capacity resources than needed. The Commission should ensure the development of effective scarcity prices and energy price formation in the market with primary revenues coming from energy pricing. A capacity component, if needed, should only focus on achieving any residual reliability gap.

iii. Ensure Comparability of Resources

Simply put, this is equal work for equal pay. First, for resources to be compensated at the same price, they should provide the same reliability support services. Resources, including demand response and intermittent renewable sources, must meet comparable capacity requirements as other resources. This is the approach the ISO-NE is proposing in its FCM Performance Incentives reform. Second, premium generation services that currently support system reliability that are not required of all capacity sellers (e.g., primary frequency response, voltage support and reactive capability) should be compensated appropriately.

[3] Similar to the ISO-NE proposed Forward Capacity Market ("FCM") Performance Incentives.

iv. Introduce a Minimum Offer Price Rule

One of the most pernicious threats to capacity market designs is the risk of manipulation by buyers. Experience in other markets demonstrates the ability of state governing bodies and regulatory institutions to game capacity prices by using subsidies for capacity resources and bidding down that capacity into the "market" at zero or near-zero prices, thereby driving down overall capacity prices. The problem has been confronted in multiple markets and remains an ongoing threat to the efficacy of capacity markets.

The establishment of a Minimum Offer Price Rule ("MOPR") is necessary to mitigate potential buyer-side manipulation. MOPR rules establish offer floors below which new capacity sellers must demonstrate the competitiveness of their capacity bid to the market monitor. This will involve considerable review and debate in determining the MOPR level for each resource technology. Any capacity market design should rigorously and effectively prevent buyer-side price suppression. The capacity market design and mitigation measure, either on the buy-side or sell-side, should allow recovery of long-term fixed costs.

v. Establish Capacity Pricing Zones

Capacity pricing should not be ERCOT-wide. Capacity pricing zones should be created to distinguish capacity values based on location. Additional granularity by constraints will be needed and additional ancillary products will be needed to manage different generation needs (e.g., local contingency protection, voltage support, etc.) within the capacity zones.

5. Should a transition mechanism be considered?

Yes. Any transition mechanism should focus on the immediate improvement of scarcity pricing in ERCOT. The ORDC should continue to be developed until it is effective. It can then act as a proper transition mechanism to any future market design.

B. Government-Sponsored Backstop – A Bad Idea

Several "backstop" concepts have been proposed that would have ERCOT and the PUC select new resources to be added to the ERCOT generation supply. These only introduce additional regulatory intervention on the market and increase regulatory uncertainty for potential investors in competitive generation.

State-subsidized generation is a market distortion that could actually depress wholesale prices in ERCOT, dampening critically needed market signals at a time when they are needed most. Investors would not consider further investment in the existing market, but would instead opt for the payment from ERCOT in the "backstop" proposal. This would drive competitive investment from the market, resulting in the need for yet more state-supported generation. This de-facto re-regulation of the ERCOT market is wholly inconsistent with the direction taken in Texas to have competitive electricity markets.

Solutions for resource adequacy should remain market-based and not undermine the competitive market by artificially picking winners and losers.

III. CONCLUSION

GDF SUEZ appreciates the opportunity to provide continued input while the PUC, stakeholders, and ERCOT work together to find market-based improvements to the ERCOT market that will enhance future reliability for consumers.

Respectfully submitted,

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