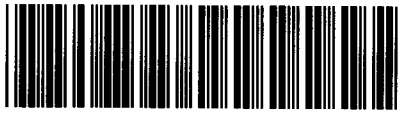

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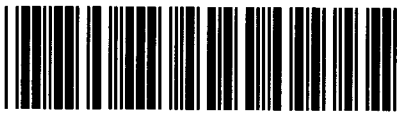

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PROJECT NO. 40000

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

COMMENTS OF THE
STEERING COMMITTEE OF CITIES SERVED BY ONCOR AND
TEXAS COALITION FOR AFFORDABLE POWER

The Steering Committee of Cities Served by Oncor and the Texas Coalition for Affordable Power (together, "Cities") are pleased to present the following responses to the questions posed by Commissioner Anderson at the open meeting of November 15, 2013.

Before reaching the specific questions posed for parties' comment, some important context for this discussion should first be considered. As the Public Utility Commission ("PUC" or "Commission") is aware, staff of the Electric Reliability Council of Texas ("ERCOT") is finalizing a revised methodology for the load forecasting that is used in the bi-annual Capacity, Demand and Reserves ("CDR") Report. ERCOT presented an overview of the changes to the methodology at the December 10, 2013 Board of Directors meeting, and stakeholder review of the new approach will occur beginning this month. A new CDR report, therefore, will not be issued imminently. At the same time, the Commission and commenting parties are faced with a resource adequacy question that has been framed by a series of CDR reports that ERCOT acknowledges have been flawed. Correcting those flaws will likely result in significant changes to the projected reserve margin. At the December 10, 2013 ERCOT Board of Directors meeting, ERCOT preliminarily reported that its load forecasts for the next three years would be significantly lower than under the current methodology. These are changes to the load forecast that will likely translate into significant improvements in the CDR's forecasted reserve margins. In short, the Commission and the market may find that correcting these errors indicates that any

resource adequacy problem is not nearly so dire as previously projected – or, perhaps, does not exist at all.

Throughout this project, Cities have advocated caution in proceeding with resource adequacy-related market design changes. As we have noted, compounding multiple changes before gauging how the market is reacting to each threatens "over steering" the market and producing unintended consequences. Now, the Commission and the market are confronted with issues in the CDR that throw into question the implicit premise of this project – that our market is broken, with its brokenness evinced by its failure to attract investment in generation sufficient to meet projected load growth. It bears stating directly: the Commission should not proceed down the path toward a market redesign as drastic as imposing a capacity construct without first determining that there is a problem. Given the pending issues related to the accuracy of the CDR, Cities continue to urge caution in adopting further resource-adequacy market design changes.

What is the legal basis for adopting a resource adequacy mechanism? What restrictions exist on the Public Utility Commission of Texas' (PUCT) authority? Does the PUCT have the legal authority to implement any mandatory generation obligation outside of an energy-only market (EOM) construct?

The Commission's authority to create a capacity market or other similar construct in Texas is far from clear. As the Commission is aware, administrative agencies in Texas have only those powers that the law confers upon them in clear and express statutory language and those reasonably necessary to fulfill a function or perform a duty that the Legislature has expressly placed with the agency.[1] Accordingly, an agency may not "erect and exercise what really

[1] *In re Entergy Corp.*, 142 S.W.3d 316, 322 (Tex. 2004); *see also State v. Public Utility Commission of Texas*, 883 S.W.2d 190, 194 (Tex. 1994).

amounts to a new or additional power for the purpose of administrative expediency."[2] Set against these presumptions, the Public Utility Regulatory Act ("PURA")[3] offers no support for adoption of a capacity market in Texas.

PURA Chapter 35

PURA Chapter 35 is the law that deregulated ERCOT's wholesale electric market, including establishing the framework by which generation providers compete upon a level playing field comprised of the system's regulated transmission grid. Section 35.002 sets forth the ability of power generators to compete in a deregulated wholesale construct. This section provides that "[a] provider of generation, including an electric utility affiliate, exempt wholesale generator, and qualifying facility, may compete for the business of selling power." To understand the deregulated wholesale market envisioned by the Legislature, the term "power", as used in this provision, must be defined. However, nowhere does PURA define the term "power."

According to accepted principles of statutory construction, "a term employed but not defined in a statute is to be given its ordinary and popular meaning."[4] The term power, as used in the context of a statute governing the state's electric industry, is commonly understood to be the product of the voltage and the current of electricity. One textbook puts the definition in plainer language, defining power as "the rate of flow of energy."[5] A very similar definition is even stated on the "Glossary" page of Reliant Energy's website, in which the company states that

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[2] *Texas Natural Resource Conservation Commission v. Lakeshore Utility Company*, 164 S.W.3d 368, 377 (Tex. 2005).

[3] Public Utility Regulatory Act, Tex. Util. Code Ann. §§ 11.001-66.017 (West 2007 & Supp. 2013).

[4] *Brookshire v. Houston Independent School District*, 508 S.W.2d 675, 678 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ).

[5] Steven Stoft, *Power System Economics*: Designing Markets for Electricity (2002).

power is "the rate of producing, transferring, or using energy."[6] The common thread through these slightly different permutations is that power refers to energy, or a flow of energy – not capacity.

While the Commission's own rules do not contain a definition of "power", the rules do include other definitions that provide some insight into how the Commission might have viewed the term in the past. For instance, the term power marketer is defined as "[a] person who becomes an owner of electric energy in this state for the purpose of selling the electric energy at wholesale."[7] This definition supports the commonly-understood definition of "power" discussed above, in that a marketer of power is really a marketer of energy.

At the same time, PURA Chapter 35 makes special provision for the procurement of ancillary services, a term defined in the law as "services necessary to facilitate the transmission of electric energy including load following, standby power, backup power, reactive power, and any other services as the commission may determine by rule."[8] Under long-accepted canons of statutory interpretation,[9] the statute's specific inclusion of ancillary services – which are capacity products – implies the exclusion of other forms of capacity sales within a market construct premised on providers of generation competing to sell *power*. In sum, Chapter 35 establishes an energy-only framework for the deregulated wholesale market, with a limited exception made for ancillary service capacity products.

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[6] http://www.reliant.com/PublicLinkAction.do?i_chronicle_id=09017522800026b4&language_code=en_US&i_full_format=jsp.

[7] P.U.C. SUBST. R. 25.5(83).

[8] PURA § 35.004(e).

[9] *See*, e.g., *Collins v. County of El Paso*, 954 S.W.2d 137, 147 (Tex. App.—El Paso 1997, pet. denied).

PURA Chapter 39

PURA Chapter 39 also casts serious doubt on the Commission's authority to implement a capacity market or other similar construct in ERCOT. Section 39.001, setting forth the Legislative policy and purpose of the Chapter, notes in subsection (a) that:

> "The legislature finds that the production and sale of electricity is not a monopoly warranting regulation of rates, operations, and services and that the public interest in competitive electric markets requires that...electric services and their prices should be determined by **customer choices** and the **normal forces of competition**." [emphasis added]

It is difficult to harmonize this legislative policy with the implementation of a capacity market. While Cities acknowledge that a capacity market structure does involve generation providers competing to provide capacity, in other respects such a structure does not square with the "normal forces of competition" and "customer choices."

Without a specific capacity market concept presented for parties to comment upon, it is not easy to gauge whether the Commission's direction will run afoul of the guidance provided by Section 39.001. Warning signs are present, however. A centralized forward capacity market involves a large number of regulatory decisions that would go towards how much capacity to procure, for what period, and other parameters that would ultimately affect the capacity price. Only at the conclusion of this regulatory process would an auction be conducted in accordance with these parameters. Then a capacity charge must be developed that in some way would be either charged to LSEs, or perhaps framed as a non-bypassable charge to customers as at least one retail electric provider ("REP") group has suggested in this project.[10] Again, without a specific market design before the Commission, this question may be premature, but the process

[10] Texas Energy Association for Marketers' Comments on Resource Adequacy Issues at 3 (Sep. 23, 2013).

just described would not be consistent with the "normal forces of competition." It is instead a highly-litigated, regulation-intensive process.

Cities appreciate that the Commission seeks input on its legal authority to make the kind of market changes that appear to be contemplated in this project, as this is always a necessary and appropriate question to ask. While the Commission contemplates whether to proceed with some form of capacity market in Texas, Cities urge that the legislative directives discussed above be kept in mind.

How does the cost of paying all capacity a clearing price at the cost of incremental capacity compare to traditional utility rate of return regulation?

At the outset, Cities must make clear that they do not favor returning the wholesale market to traditional utility regulation. However, this question does highlight the risk of establishing a specific, separate market in which resource owners seek to obtain fixed cost recovery. Cities expect that the cost of paying all capacity a clearing price at the cost of incremental capacity would be higher than the fixed cost recovery afforded utilities subject to cost-of-service regulation.

As the Commission is aware, in the current energy-only market design, resource owners obtain fixed cost recovery (as well as return) through the quantity of revenue received in excess of their own offers, which presumably are based on their resources' marginal cost. Fixed cost recovery could also be provided by participation in the ancillary services markets. If ERCOT implements a capacity market, on the other hand, recovery of fixed costs will come not only through these sources, but through the capacity market itself. Furthermore, within that market, most resource owners will obtain additional revenue to the extent that their own incremental cost of capacity is less than the clearing price for capacity. Note too, that this is premised on resource owners offering their capacity or energy at or near their short run marginal cost; if generators

increase their offers beyond that level, clearing prices could increase, resulting in an even greater degree of fixed cost recovery.

This is much different than the fixed cost recovery that would occur under traditional regulation. Under the current regulatory system, public utilities in Texas obtain fixed cost recovery, in large part, through the depreciation expense included in their rates. The depreciation rates do not apply on anything approximating a clearing price basis – a particular plant receives the appropriate depreciation rate for its type. A utilities' overall depreciation expense is particular to it; a utility does not receive the highest depreciation expense awarded to any other utility for the same time period.

Cities acknowledge that the comparison just drawn is rough and approximate only; cost recovery in deregulated and regulated systems clearly operates differently. Yet it is difficult to see how breaking out fixed cost recovery into a separate, additional market that establishes a clearing price for all capacity is less costly than traditional regulation.

How does pricing energy market revenues based on the market clearing price of energy compare to traditional utility fuel recovery?

The two forms of fuel cost recovery operate much differently. Under Texas' regulatory regime, public utility fuel expenditures are subject to dollar-for-dollar recovery, provided that the expenditures were prudently incurred. This dollar-for-dollar recovery is achieved by a reconciliation and surcharge/refund process, and ensures that the utility recovers its fuel costs and only its fuel costs, without return.

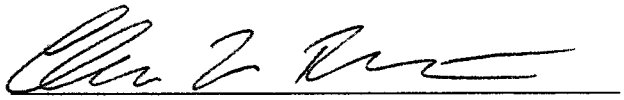
In our current deregulated wholesale model, generators must recover their fuel costs through energy prices, and must calculate their offer prices to both recover their fuel (and other variable) costs and maximize the opportunity for their plant to be dispatched. In this manner, recovery of fuel costs is at the generators' risk, which theoretically drives prudent behavior and

efficient outcomes. If a generator's offer is accepted and the plant dispatched, revenue in excess of the offer price goes towards fixed cost recovery and return or profit. This cost recovery, too, is at risk in an energy-only market, a result not only appropriate from a policy and incentive perspective, but entirely consistent with Senate Bill 7's intent of placing the risk of generation investment on shareholders rather than ratepayers.

Dated: December 16, 2013.

Respectfully submitted,

LLOYD GOSSELINK
ROCHELLE & TOWNSEND, P.C.
816 Congress Avenue, Suite 1900
Austin, Texas 78701
(512) 322-5800
Fax: (512) 472-0532
cbrewster@lglawfirm.com



CHRISTOPHER L. BREWSTER
State Bar No. 24043570

ATTORNEYS FOR STEERING COMMITTEE
OF CITIES SERVED BY ONCOR AND TEXAS
COALITION FOR AFFORDABLE POWER