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PROJECT NO. 37897

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**PUC PROCEEDING RELATING TO
RESOURCE AND RESERVE
ADEQUACY AND SHORTAGE
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**BEFORE THE
PUBLIC UTILITY COMMISSION
OF TEXAS**

**COMMENTS OF THE
STEERING COMMITTEE OF CITIES SERVED BY ONCOR
IN RESPONSE TO JANUARY 31, 2012
COMMISSION REQUEST**

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

The Steering Committee of Cities Served by Oncor ("Cities") appreciates the Public Utility Commission's ("PUC" or "Commission") invitation to provide comments in this project regarding various aspects of the Commission resource adequacy and market power rules, P.U.C SUBST. R. 25.505 and 25.504, respectively. In its January 31, 2012 solicitation of comments, the Commission poses seven questions relating to various aspects of these rules, some containing sub-questions. Cities address a number of these questions below, in particular, numbers 1, 2, 3, and 4.

- 1. How have the recent changes to the protocols that affect reliability deployments of ancillary services affected your views on your proposed changes to these rules?**

In the last several months, the ERCOT stakeholder process has approved a number of Nodal Protocol Revision Requests ("NPRRs") that have arisen from this project since mid-2011. Cities have made observations to this effect in prior comments in this project, but it bears repeating — the express intent of those NPRRs was to increase wholesale prices relative to the then-current status quo.

The details of those NPRRs render P.U.C. SUBST. R. 25.505 even more determinative of wholesale pricing in ERCOT than they otherwise would be. The reason is that many of the NPRRs use the System-Wide Offer Cap ("SWOC") as a means to set prices during the

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deployment of various kinds of ancillary services. Whereas, prior to the end of 2011, the SWOC acted primarily as a *constraint* on permissible energy offer prices in this market, the recent NPRRs transform the SWOC into a mechanism to *increase* prices under certain conditions.

For example, NPRR 435, recently approved by the Technical Advisory Committee (“TAC”) and soon to be before ERCOT’s Board of Directors, would price all energy deployments from units committed through the Reliability Unit Commitment (“RUC”) process at the SWOC. Significant debate among stakeholders occurred on this issue, and there was no consensus that the SWOC is the proper price to use for this purpose. This debate included whether RUC deployments are truly indicative of scarcity of resources, or instead, represent transitory issues such as ERCOT’s load forecast being incorrect. These debates aside, if ultimately approved by the Board of Directors, NPRR 435 would render the SWOC extremely meaningful in setting prices in ERCOT. Similar mechanisms are now in place for other ancillary services as well — deployments of both Regulation Reserve Service and Responsive Reserve Service are to be priced at the SWOC under another recent NPRR.¹

Accordingly, an increase to the SWOC should not simply be viewed as permitting resource owners additional leeway to make higher-priced offers. Such an increased SWOC would plug into a recently-approved structure that is intended to specifically produce prices at that figure. The increased significance of the SWOC in the ERCOT market informs Cities’ position that the SWOC should *not* be increased, as detailed in Cities’ response to Question No. 2, below.

¹ See NPRR 427, Energy Offer Curve Requirements for Generation Resources Assigned Reg-Up and RRS.

2. **Should the Commission consider an increase in the System Wide Offer Cap (SWOC)? If so, on what schedule should any increase be implemented? What would be the likely impact on contracting decisions by existing and prospective generation owners, retail electric providers, electric cooperatives, municipally owned utilities and retail customers? What would be the impacts on forward price signals and would those impacts be conducive to the development of new generation capacity in the ERCOT market?**

No, the SWOC should not be increased at this time. As noted in Question No. 1, above, the ERCOT stakeholder process has recently adopted a number of market design changes intended to place prices at the SWOC when certain ancillary services are deployed. As a result, the Commission can reasonably expect to see wholesale pricing at the SWOC with greater frequency in 2012.

The issue of whether pricing is adequate to support new investment has two dimensions: the level of pricing experienced, and the frequency/duration of high prices. Since last summer, the Commission has directed that significant steps be taken to increase the frequency and duration of prices at the SWOC. It would be premature to now increase the SWOC itself; in the near term, the market and the Commission will have little data on how the recent market design changes have affected prices in ERCOT. To increase both the SWOC *and* the frequency with which it is imposed on load may produce unpredictable results. Cities ask the Commission to consider whether compounding market changes in this manner will result in an overcorrection that would create unnecessary costs on Texas consumers. Before any changes are made to the SWOC, Cities urge that the Commission evaluate pricing data that results from the several market changes intended to increase prices that are pending or that have been implemented only very recently. Once the market has experience under these new measures, the Commission can consider further changes — including changes to the SWOC — if it deems appropriate.

3. **Should the Commission raise or eliminate the Low System Offer Cap (LCAP) and its triggering mechanism? If so, on what schedule should the change be implemented? What would be the likely impact on contracting decisions by existing and prospective generation owners, retail electric providers, electric cooperatives, municipally owned utilities and retail customers? What would be the impacts on forward price signals and would those impacts be conducive to the development of new generation capacity in the ERCOT market?**
4. **Does the Scarcity Pricing Mechanism that uses the Peaker Net Margin to monitor the adequacy of price signals to bring new generation to the ERCOT market still have value? Are other changes needed in P.U.C. SUBST. R. 25.505(g)(6)(E) to give better data about whether the market design allows for adequate revenues to cover the cost for new entry?**

Cities addresses these two questions together because the Peaker Net Margin (“PNM”) concept addressed in Question No. 4 provides the triggering mechanism for the Low System Offer Cap (“LCAP”) addressed by Question No. 3. The PNM/LCAP construct continues to have merit in the ERCOT market, but the rationale underlying the PNM mechanism must be properly understood. Under the current rule, PNM is calculated by deducting a cost amount calculated at ten times the Houston Ship Channel price index for the previous day from real time energy prices for each settlement interval for that day.² When PNM during a year reaches \$175,000 per MW, the LCAP becomes effective.³

However, the market failing to reach \$175,000 PNM is not a signifier of inadequate price signals. When the resource adequacy rule was adopted in 2006, the Commission decided to include the PNM/LCAP mechanism based on specific considerations:

“The rule, as amended, has set the PNM to allow more than twice the annualized fixed costs of a new gas-fired peaking unit...”⁴

² P.U.C. SUBST. R. 25.505(g)(3) and (4).

³ P.U.C. SUBST. R. 25.505(g)(6)(E).

⁴ *Rulemaking on Wholesale Electric Market Power and Resource Adequacy in the ERCOT Power Region*, Project No. 31972, Order Adopting Amendment to §25.502, New §25.504, and New §25.505 as Approved at the August 10, 2006, Open Meeting at 73 (Aug. 23, 2006).

....

“The commission agrees...that an important purpose of the LCAP is to prevent excessive transfers of wealth from load to generation during years when reserve margins are thin.”⁵

....

“[T]he commission has determined that the proposal by Joint Commenters to raise the PNM to \$350,000 per MW would lead to excessive transfers of wealth from load to generation without any additional benefits to the market.”⁶

As these excerpts make clear, the \$175,000 per MW PNM threshold, and the LCAP that would result from meeting that threshold, were understood to be measures for customers' protection. Failing to meet the rule's stated PNM figure for a given year should not be viewed, in itself, as a sign of market failure. Indeed, as the Commission highlighted in the first excerpt above, PNM was set at more than twice the annualized fixed costs of a new gas-fired peaking unit. The PNM therefore was intended as a mechanism to permit peaking generation to cover substantially more than its costs, while protecting customers from excessive levels of wealth transfer.

On this basis, Cities urge that the PNM provision in the current rule be retained. As the Commission is aware, the \$175,000 per MW PNM threshold has never been reached since its adoption in 2006. Accordingly, the LCAP has never been imposed. As a result, it is difficult to conclude that the protection afforded load by the PNM and LCAP mechanisms have in any way hindered the wholesale market, or have affected wholesale prices.

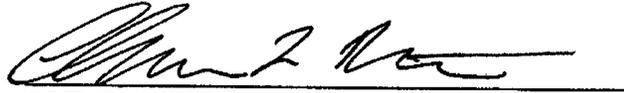
Dated: February 10, 2012.

⁵ *Id.* at 121.

⁶ *Id.* at 124.

Respectfully submitted,

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