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PUC PROCEEDING RELATING TO RESOURCE AND RESERVE ADEQUACY AND SHORTAGE PRICING	§ § § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

TEXAS INDUSTRIAL ENERGY CONSUMERS' COMMENTS

I. INTRODUCTION

Texas Industrial Energy Consumers (TIEC) submits these responses to the Commission's request for comments issued on February 3, 2012. TIEC has historically taken the position, and continues to believe, that the Commission should address any resource adequacy concerns by allowing prices to rise during true scarcity conditions. This construct allows loads and generators to hedge against the high prices if they wish, and also gives the scarcity premiums to the generators that are actually providing energy under scarcity conditions. Further, if high prices are directly tied to scarcity, these price impacts will be reduced as installed and available capacity increases. This is an efficient result. In contrast, TIEC opposes proposals that attempt to address resource adequacy by artificially raising prices under conditions that do not indicate a shortage of installed capacity. With these general principles in mind, TIEC's responses to the Commission's questions are below.

II. RESPONSE TO COMMISSION QUESTIONS

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?

Several significant changes were adopted at the December Board meeting and more will be considered at the February meeting. At this point it is too soon to tell how these changes will impact resource adequacy and the market. The Commission should exercise significant caution in making additional changes to the market design without giving these recent and pending changes an opportunity to have an impact. This is of particular concern given that some of these changes will interact with other market features and may have unintended consequences.

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- The following changes were adopted in December:[1]
  - Responsive Reserve Service (RRS) priced at the SWOC.
  - Regulation-Up priced at the SWOC when deployed by SCED.
  - Non-Spinning Reserve Service (NSRS) price floors of $120/MWh for online and quick-start and $180/MWh for offline.
- The following changes will be addressed at the February Board meeting:
  - Pricing Reliability Unit Commitment (RUC) for Capacity at the SWOC (alternative proposal is $500/MWh)[2]
  - Moving 500 MW of NSRS to RRS, thereby removing it from SCED until the SWOC is reached.
  - Authorizing ERCOT to execute Reliability Must Run (RMR)-style contracts for system capacity. The TAC-approved version prices this energy at the SWOC.[3]
- The following changes are being considered in subcommittees and task forces:
  - Price increases during Emergency Interruptible Load Service (EILS) deployment.
  - Price increases related to 0-LSL energy from certain services.
  - Changes to the Power Balance Penalty Curve and SWOC.
  - Removing the RUC clawback to increase generator revenues.

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?

As TIEC has stated previously in comments and before the Commission, the proper way to address resource adequacy in an energy-only market is by allowing prices to rise during conditions that indicate a scarcity of capacity. Assuming that the market is properly designed so that the SWOC only comes into play under true scarcity conditions, adjusting the SWOC would be an appropriate way to address resource adequacy concerns. TIEC opposes attempts to address

[1] *See* Nodal Protocol Revision Requests (NPRRs) 426-428, adopted on Dec. 12, 2011 and effective January 5, 2012.

[2] NPRR 435.

[3] NPRR 432.

resource adequacy by pricing energy at the cap during conditions that do not indicate a capacity shortage.

Increasing the SWOC will increase risk for all market participants, which will encourage risk-averse loads and generators to protect themselves against spot-market volatility.[4] Loads and generators will seek to hedge against this risk by buying forward, which will increase the average prices for power for all retail customers who are seeking contracts during this period. This will, in turn, increase the price received by generators for the output of their generation. Given current growth in demand for electricity, this should also increase the impetus for generators to build units, as these forward products will ultimately require some level of physical supply. Based on these dynamics, adjusting the SWOC should have a direct impact on resource adequacy.

TIEC is still considering the appropriate timeframe that will be required to review and implement any changes to the SWOC. TIEC would note that the market must be given sufficient notice so that it can adjust to the new pricing regime and execute new contracts or obtain appropriate hedging products.

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?**

TIEC opposes eliminating the LCAP. As the Commission explained in adopting the LCAP, it is intended to "protect[] customers from excessive wealth transfers" to generators during years of low reserve margins.[5] Given the low projected reserve margins, the slate of market price changes being implemented or considered at the Commission and ERCOT, and the unknown interactions of these changes, the Commission should maintain this type of protection for consumers. The current LCAP trigger is set at a very high level, far in excess of the actual

[4] TIEC notes that if the SWOC is increased, accompanying changes to the Power Balance Penalty Curve may be appropriate. Specifically, the "ramp" of the curve may need to be softened so that loads and generators have sufficient time to respond to price signals before reaching the SWOC. This was proposed as part of the CPS Energy proposal earlier in this proceeding.

[5] *See* Project No. 31972, Order at 74 (Aug. 24, 2006).

net revenue requirement that would be required for a peaker to recover its annual fixed costs.[6] TIEC is open to discussion on whether the trigger for the LCAP should be modified, but it is essential to maintain this type of protection for consumers.

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?**

The Peaker Net Margin threshold is the same as the LCAP trigger. Again, this is not intended to be a "target" revenue level for generators or a barometer for the effectiveness of scarcity pricing. Instead, the Peaker Net Margin trigger is a circuit-breaker that is intended to protect consumers against excessive wealth transfers to generators. The Commission explained that when the current Rule 25.505 was adopted, it "set the PNM to allow more than *twice* the annualized fixed costs of a new gas-fired peaking unit."[7] The 2010 State of the Market Report indicates that the current net revenue requirement needed to meet the annualized fixed cost requirement of a peaker is approximately $80,000-$105,000 per MW-year (including carrying costs). This is still far below the LCAP trigger, demonstrating that this trigger is not an appropriate yard stick for the effectiveness of scarcity pricing mechanisms. If the Commission compares generator revenues to Peaker Net Margins to examine the effectiveness of scarcity pricing, the Peaker Net Margin level should be compared to the *actual* annualized revenue requirement for a peaking unit—not the $175,000 threshold that triggers the LCAP. The LCAP and PNM trigger should be maintained as a protection for consumers, but not as any kind of a generator revenue target.

5. **Should the Commission consider an increase in the amount of generation owned by a single generation entity in order for the entity to qualify for the exemption listed in P.U.C. Subst. R. 25.504(c)? Should the Commission consider excluding new generation installed by an entity after January 1, 2012 in the calculation prescribed by that subsection?**

TIEC does not believe that either of these suggestions would be prudent or effective. TIEC has never been very supportive of the exemption created by 25.504(c). This exemption

[6] 2010 State of the Market Report at xiii.

[7] *See* Project No. 31972, Order at 73 (Aug. 24, 2006)(emphasis added).

allows generators with a market share below 5% to bid much higher than their marginal cost without being susceptible to a market power abuse violation, and is commonly known as the "small fish swim free" exemption. TIEC believes that the test for market power abuse should be uniformly applied regardless of a generator's market share, and that inducing higher prices by allowing exceptions to this policy is not scarcity pricing and is not the optimal approach. Similarly, excluding generation after a certain date in determining when this exception applies would appear to be arbitrary, unprincipled, and potentially discriminatory, and would likely lead to adverse consequences.

6. Would the creation of a "safe harbor" with respect to a level of pricing that would not constitute an offer "substantially above... marginal cost" according to P.U.C. Subst. R. 25.504(d) provide benefits to the market place? If so, what should be the form and level of that "safe harbor"?

Creating a safe harbor would allow generators with market power to increase prices above competitive levels. This is a market power abuse and is barred by PURA. Under this principle, TIEC does not agree that a "safe harbor" for bidding above marginal cost is an appropriate or advisable approach to addressing resource adequacy. TIEC believes that the Commission's efforts would be better focused on re-examining the current SWOC for the reasons discussed previously.

7. Are there other changes to P.U.C. Subst. R. 25.504 that would be conducive to ensuring that the market effectively signals and is conducive to the development of new generation capacity in the ERCOT market?

TIEC has no additional changes to suggest at this time.

III. CONCLUSION

TIEC appreciates the opportunity to submit these comments and looks forward to discussing these issues further at the upcoming workshop.

Respectfully submitted,

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