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PROJECT NO. ~~37897~~

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PUBLIC UTILITY COMMISSION  
FILING CLERK

PUC PROCEEDING §  
RELATING TO RESOURCE §  
AND RESERVE ADEQUACY §  
AND SHORTAGE PRICING §

BEFORE THE PUBLIC  
UTILITY COMMISSION OF  
TEXAS

**RESPONSE OF THE CITY OF AUSTIN D/B/A/ AUSTIN ENERGY  
TO THE PUBLIC UTILITY COMMISSION'S PROPOSAL FOR PUBLICATION  
OF NEW §25.508, AS APPROVED AT THE APRIL 12, 2012 OPEN MEETING**

**TO THE HONORABLE PUBLIC UTILITY COMMISSION:**

NOW COMES the City of Austin d/b/a Austin Energy, (Austin Energy) and files these comments in response to the Public Utility Commission's (Commission) Proposal for Publication of new §25.508, Relating to the High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region as follows:

Austin Energy supports the Commission's efforts to address refinements to the parameters with which the Commission anchors the energy-only wholesale market design. Austin Energy has taken part in these efforts not only through the Commission's projects, and rulemaking activities, but also through the ERCOT stakeholder process.

The Commission has two proposals out for comment relating to the subject of resource adequacy; one in the instant project and one in Project No. 40268, PUC Rulemaking to Amend PUC SUBST. R. 25.505, Relating To Resource Adequacy In the Electric Reliability Council Of Texas Power Region. While the proposal in Project No. 40268 addresses several design parameters of ERCOT's energy-only resource adequacy mechanism, both proposals seek to increase the high system-wide offer cap (SWOC). The salient difference between the two proposals regarding the implementation of the SWOC increase is the timing. New §25.508 implements an increase to the SWOC on August 1, 2012, while the proposal for

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publication in Project No. 40268, implements increases to the SWOC beginning in June 1, 2013.

The Commission's proposition to increase the SWOC on August 1, 2012 exposes load serving entities (LSEs) to increased market volatility and potentially higher credit requirements. The compressed timeframe could make it difficult and/or expensive for LSEs and other market participants to acquire necessary collateral. In addition, the ERCOT market stakeholder process is struggling to adjust its credit policies in anticipation of the abrupt changes the proposed rule would impose. Austin Energy agrees the SWOC bears scrutiny, but does not support the timing the Commission has proposed in Project No. 37897. It therefore urges the Commission to reject adoption of new §25.508 and instead focus its efforts on the proposal in Project No. 40268.

The Commission also requests comment on the following question:

The direct effect of the new section will be to allow resources to offer services in the ERCOT ancillary service auctions at higher prices. In turn, this direct effect is expected to increase revenues to resources, which will be paid for by LSEs, including retail electric providers. Will the new section implicate the provisions of §25.475 that allow retail electric providers to change rates in fixed-rate products for retail customers due to "changes resulting from federal, state or local laws that impose new or modified fees or costs on a REP that are beyond the REP's control?"

*Answer to Question*

At this juncture Austin Energy is inclined to leave the legal opining on whether the new section implicates the relevant provisions of §25.475 to REPs' attorneys. However, Austin Energy notes that when a LSE defaults in the ERCOT market, that default is borne by the entire market. The REP's customers will be transitioned to other REPs or the provider of last resort; the market will bear the short pay uplifts of the defaulting REP; and, as other market participants bear the financial burdens of defaulting REPs, they themselves become vulnerable to default. In asking this question, it is apparent that the Commission is aware that the few months allotted between adoption of

the rule and implementation of the higher SWOC will not allow all market entities to enter into the financial arrangements necessary to manage the increased risk environment created by the new rule.

*Comments on Proposed Rule*

Austin Energy is deeply concerned with potential impacts resulting from a SWOC increase being implemented on August 1, 2012. Austin Energy does not only fear that the increased price volatility poses a potential financial threat to LSEs which could result in defaults that will affect all ERCOT market participants, but also believes that even adequately hedged LSEs may find themselves undercapitalized to meet the credit requirements necessary to transact in the ERCOT market with the higher SWOC. Given time, as allowed by the schedule proposed in Project No. 40268, entities might well be able to ameliorate this issue, but addressing the change in such a compressed time frame could be problematic.

The credit implications are not only potentially grave for an individual market participant, but are also of importance market-wide. ERCOT stakeholders are currently in the process of wrestling with necessary changes to ERCOT's credit policies in light of the proposed changes to the SWOC. Nodal Protocol Revision Request (NPRR) 459 – Better Matching Forward Collateralization with Forward Risk in the Real-Time Market, is undergoing review. NPRR 459 has been characterized as a “stop gap” measure and given “Urgent” status by the Protocol Revision Subcommittee. In response to its Urgent status, Market Credit Working Group (MCWG) and Credit Working Group (CWG)<sup>1</sup> have had a special meeting devoted to its review, as has the Wholesale Market Subcommittee (WMS). Members of WMS, MCWG, and CWG have all indicated that they would prefer more time to develop a predictive methodology to deal with the dilemma that the higher SWOC will present in terms of volatility and adequate market collateralization without the burden of over collateralization. NPRR 459 attempts to employ predictive methodologies, but relies on considerable ERCOT staff subjectivity and discretion which

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<sup>1</sup> Market Credit Working Group is a working group of the Wholesale Market Subcommittee tasked with providing input and recommendations on issues of credit risk management. Credit Working Group is a working group of the ERCOT Board of Directors established as an independent group of credit professionals to help ensure that appropriate procedures are implemented to mitigate credit risk.

will make it difficult for market participants to shadow and replicate in their own mid-offices. Austin Energy has thus far supported NPRR 459 because the timing of the proposed rule appears to allow for no better alternative than the proposed stop gap.

As noted, Austin Energy believes that the Commission is doing its due diligence to work within the confines of the energy-only wholesale market design to address the resource adequacy challenge. As that challenge continues to be met, each regulatory change should only be made if the benefits clearly outweigh the costs. To date the Commission has encouraged, and the ERCOT Board has adopted, NPRRs modifying wholesale market rules to halt price reversals seen during the deployment of reliability services. The Commission is working with ERCOT to identify additional issues and appropriate responses through ERCOT's contract with the Brattle Group. The Commission's efforts have been met with considerable success. ERCOT will have 2000 MWs of mothballed generation resources back in service for the summer peak—400 MWs over last summer; and, at least one power producer has announced 550 MW of brown field generation expansion to come online in 2014.<sup>2</sup>

Austin Energy does not believe there is incremental benefit to be gained before this summer from adoption of this rule, and is concerned that adoption poses incremental risks. In light of the similar and additional changes sought in Project No. 40268 and its extended timeline, which allows for market entities to make necessary adjustments to mitigate financial risk, Austin Energy recommends the Commission reject the proposal for publication in Project No. 37897 and focus its efforts on Project No. 40268.

Austin Energy appreciates the opportunity to comment on the Commission's proposed for publication.

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<sup>2</sup> 04/27/2012, Calpine Reports First Quarter 2012 Results, Raises 2012 Guidance, <http://phx.corporate-ir.net/phoenix.zhtml?c=103361&p=irol-newsArticle&ID=1688383&highlight=>

Respectfully Submitted,

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