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PROJECT NO. 40268

PUC RULEMAKING TO AMEND §  
PUC SUBST. R. §25.505, RELATING TO §  
RESOURCE ADEQUACY IN THE §  
ELECTRIC RELIABILITY COUNCIL §  
RELIABILITY COUNCIL §  
OF TEXAS POWER REGION §

PUBLIC UTILITY COMMISSION  
OF TEXAS

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COMMENTS OF PANDA POWER FUNDS, LLC  
CONCERNING RESOURCE ADEQUACY

Panda Power Funds, LLC ("Panda") respectfully submits its comments in the above-styled rulemaking relating to long-term resource adequacy in the Electric Reliability Council of Texas, Inc. ("ERCOT") power region, both with regard to the proposed rule and to the Brattle Group report titled "*ERCOT Investment Incentives and Resource Adequacy*" (the "Brattle Report") that was commissioned by the Public Utility Commission of Texas ("PUCT" or "Commission") through ERCOT and filed in this proceeding. Panda supports the actions taken by this Commission to date to address shrinking reserve margins and provides these comments regarding the signals necessary to support investment in the addition of new capacity in the ERCOT market.

The proposal for publication seeks input concerning whether and how to modify the scarcity pricing mechanisms including by increasing the high and low system-wide offer caps and the peaker net margin, in order to encourage the development of new generation resources, given that ERCOT reserve margins are projected to decline precipitously over the next few years if new baseload capacity is not added. As an active participant in the earlier build-out of capacity in the ERCOT market, and as a developer that is planning new capacity additions in the

ERCOT market, Panda directly faces the challenges detailed in the Brattle Report that investors have with the current market structure. Despite steps in the right direction that the Commission has already taken, investment remains insufficient to meet the growing demand of Texas. As recognized by the Brattle Report and by the Commission during the discussion of these issues at the June 13<sup>th</sup> Open Meeting, a gap remains between the revenues a generator can receive in the market and the cost to build a project and obtain a reasonable return. The project cost alone cannot be covered by current market prices.

Moreover, reserve margins are projected to fall below 9.8% by 2014 and there is a need to increase the reliability target from 13.75% to 15.25%. Despite these facts, developers such as Panda cannot obtain the long-term power purchase agreements necessary to finance a project. These power purchase agreements are instrumental to project financing because they provide a project with both an energy and a capacity payment. Because power purchase agreements are not available to developers, the revenue streams necessary for development must be obtained purely through merchant mechanisms available in the ERCOT markets.

The Commission should be aware that market participants are not seeking power purchase agreements for project financings because market signals allow them an alternative, without the accompanying cost of resource adequacy. The Brattle Report highlights this disconnect between the resource adequacy requirement set by the Commission, and the lack of an obligation in the market that such resource adequacy requirement be met. Of the five policy options recommended by the Brattle Report, each seeks to close this gap.<sup>1</sup> Each policy

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<sup>1</sup> The Brattle Report recommended without regard to preference the following options: 1) Energy-only with market-based reserve margin; 2) Energy-only with adders to support a target reserve margin; 3) Energy-only with backstop procurement at minimum acceptable reliability; 4) Mandatory resource adequacy requirement for load serving entities; and 5) resource adequacy requirement with a centralized forward capacity market. See Brattle Report at 4, 104-117 and 120-121.

recommendation attempts to create a bridge between obligations to purchase energy in the market and meeting the Commission's resource adequacy requirement.

In analyzing these recommendations, it is clear that there is a recognition that the market does not have the incentive to meet the resource adequacy requirements of the Commission. Under current market design, only when all available supply has been contracted for peak periods will scarcity pricing begin in earnest—at which time financing for, and construction of, new baseload capacity will begin in earnest. Such timing is too late to avoid both unfavorable and sustained pricing impacts to consumers and rolling outages which can have a deleterious impact on both customers and the broader economy. As a result, while ERCOT has determined that there is adequate capacity for this summer, signals being sent now can facilitate capacity additions for the summers of 2014 and 2015, provided that the disconnect between the generation capacity the Commission requires to be part of the reserve margin, and the signals to the market to support that reserve margin, is resolved.

ERCOT and the Commission have acknowledged that resource adequacy is a primary concern to meet the growing demand of Texas. Panda recognizes that there are two parts to the resource adequacy problem: (i) ensuring resource adequacy in the near-term through the adoption of this amendment, and (ii) ensuring resource adequacy in the long-term through policy changes. For the reasons set forth above, the Brattle Report notes that because wholesale market conditions in ERCOT have not been favorable to investors, investment is stalling, threatening resource adequacy in the near-term. The Brattle Report solutions emphasize the need for both capacity additions and demand response. With the growth of the economy in Texas, even with much-needed demand response, new capacity must be constructed. Investors interested in new generation to support the growing economy, both as a good investment and to serve the ERCOT

grid's reliability needs with new capacity, are discouraged from investing by current rates of return. Panda is concerned that delays in actions by the Commission may further soften investor interest.

The proposed increases in both the low system offer cap and the high system offer cap beginning as soon as practicable are essential to the development of generation resources in ERCOT to support the current reliability target of 13.75%, notwithstanding the need to increase the reliability target to 15.25% to meet the Commission's reliability requirement. As suggested by the request for comments, Panda recommends increasing the caps by April of 2013, which would provide time for the market to react while sending pricing signals to the market earlier. Moreover, Panda recommends (i) consolidating the increases into two steps rather than three or four, and (ii) setting the high offer cap at a minimum of the \$9,000 level recommended in the Brattle Report.

Panda supports the policy recommendations in the Brattle Report, though implementation must be expedited to send signals to the market demonstrating the Commission's commitment to resource adequacy. This is the hallmark of the Commission and one reason investing in the ERCOT market is attractive—the Commission makes its decision to move forward, implements that decision, and provides regulatory certainty for investors and market participants alike.

Panda believes that the surest way to achieve the target reserve margin is either to (i) implement a capacity market, or (ii) require that the reserve margin be carried by load serving entities, and passed through to consumers. Allowing for a market-based mechanism to meet the reserve margin is, Panda believes, preferable to an administrative mechanism that would need to be modified or tweaked over time, creating uncertainty in the market and requiring intervention

by the Commission. These preferred options are the first and fifth of the Brattle Report's recommendations.

From the discussion at the Open Meeting on June 13<sup>th</sup>, it appears that a separate project will be opened to more closely examine the Brattle Report and that a workshop relating to the Brattle Report will be held in that proceeding. Panda believes it is critical that the Commission, in this proceeding, adopt the published rule quickly so as to signal the market that the Commission is taking the requisite steps to attract new investment in generation in ERCOT. Panda encourages the Commission to (i) move forward with the Brattle Report recommendations so as to impact the forward markets and send signals that investment in the ERCOT market is both needed and warranted; and (ii) adopt long-term policy changes such as the implementation of a forward capacity market. Without the adoption of this amendment, and the long-term policy changes recommended in the Brattle Report, Panda believes appropriate market signals will not be sent to either the investment community or entities that could sign power purchase agreements. Without those signals much-needed ERCOT generation projects will not be financeable.

Panda appreciates this opportunity to provide these comments.

Respectfully submitted,

A handwritten signature in cursive script, reading "Diana Liebmann".

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