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PROJECT NO. 40000

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

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PUBLIC UTILITY COMMISSION

GOLDEN SPREAD'S COMMENTS
REGARDING
OPTIONS FOR ACHIEVING THE RELIABILITY GOAL

TO THE HONORABLE PUBLIC UTILITY COMMISSION:

Golden Spread Electric Cooperative, Inc. ("**Golden Spread**") respectfully submits these comments in response to the Public Utility Commission's ("**PUC**" or "**Commission**") Notice of Workshop in Project No. 40000, Proceeding to Ensure Resource Adequacy in Texas. In preparation for the September 6, 2012, workshop, the Commission requested in its Notice of Workshop that interested parties submit comments on their preferences regarding the policy options set out in Table 1 in the in the Brattle Group, Inc.'s ("**Brattle Group**") report entitled "ERCOT Investment Incentives and Resource Adequacy" (the "**Brattle Report**") originally filed on June 1, 2012, by the Electric Reliability Council of Texas, Inc. ("**ERCOT**") in PUC Project No. 40268.

I. INTRODUCTION AND SUMMARY

In these comments, Golden Spread reaffirms its support for Option 4 as the best option among those recommended in the Brattle Report to promote the achievement of resource adequacy in the ERCOT.¹ In addition, Golden Spread provides a more detailed proposal on how Option 4 can be implemented with the least cost and disruption to the existing market structure and in a manner that takes into account the legitimate interests of all market participants.

Option 4 is a market-based competitive approach that can be implemented without introducing the complexities, expense, centralized control and other problems associated with Option 5. Option 4 in essence creates a bilateral market for the trading of "capacity" or "reliability" credits," much like the current system of renewable energy credits. This paradigm is familiar to all ERCOT market

¹ Golden Spread filed comments on July 11, 2012 in Project 40480, which supported Option 4 among the options recommended in the Brattle Report. Those comments have since been incorporated in this proceeding

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participants and can be accommodated with little disruption to the existing ERCOT market structure. At the same time, Option 4 creates incentive for load serving entities (“LSEs”) to secure resources sufficient to serve their loads plus a mandatory reserve margin. Additionally, Option 4 provides a reliable revenue stream that will help market participants obtain lower cost financing of worthwhile projects, as confirmed in comments filed by representatives of the financial community.²

Golden Spread and its member rural distribution electric cooperatives unequivocally agree with Chairman Nelson’s observation that for Texans “reliability is paramount.”³ Despite Golden Spread’s commitment to provide economical, efficient and reliable generating resources to serve its members’ loads in the ERCOT region, if there is insufficient capacity to reliably serve the ERCOT region as a whole, Golden Spread’s members along with all other Texans in the ERCOT region suffer the intolerable risks of rolling blackouts. These include not only the associated direct costs should involuntary service disruptions occur but also the resulting discouragement of economic development whether they occur or not. The Brattle Group’s July 27 Workshop Presentation confirms Chairman Nelson’s conclusion that increases to the offer cap in the current energy only market will not allow the market “to achieve a reserve margin consistent with the one event in 10 years standard.”⁴ “This market will not support enough investment to meet the target reserve margin.”⁵

Golden Spread recommends that the Commission direct ERCOT to begin working to implement an Option 4 solution consistent with these comments. The Commission should at the same time, however, allow the ERCOT sufficient time to observe the Brattle Report’s precaution to not implement market design changes too quickly, without sufficient stakeholder consideration and ample time to prepare for the implementation.⁶ Golden Spread’s proposal contemplates Commission conceptual approval this year, aimed at implementation through the ERCOT collaborative process for the summer peak of 2016.

²See Supplemental Comments of GSO CAPITAL PARTNERS LP AND STONE LION CAPITAL PARTNERS L.P. (“Debt Investors Comments”) supporting a policy option largely in the form of Option 4, at page 1. These commentators are self-described “debt investors that hold and or contemplate making debt investments in generation capacity in ERCOT.”

³ Memorandum from Chairman Donna L. Nelson to Commissioners Kenneth W. Anderson, Jr. and Rolando Pablos, dated August 16, 2012, RE: August 17, 2012 Open Meeting Agenda Item 26; Project No. 40000 - Commission Proceeding to Ensure Resource Adequacy in Texas (“Chairman Nelson Memorandum”), at page 1.

⁴ Id. at 2.

⁵ PUC Project 40480; Item 32, *ERCOT’s Submission of ERCOT’s and the Brattle Group’s Presentations, and the Brattle Group’s Responses to Entities’ Technical Questions to be Addressed at the July 27, 2012, Commission Workshop*, Attachment B, Bates p. 000021.

⁶ Brattle Report at 120. As Chairman Nelson put it “... it is critically important for us to move swiftly to resolve regulatory uncertainty and support investment, while remaining mindful of the fact that stakeholder involvement is needed to craft a solution that will provide the greatest level of reliability at the most competitive prices, because both are important.” Chairman Nelson Memorandum at page 1.

II. GOLDEN SPREAD'S INTEREST

Golden Spread is a non-profit electric generation and transmission (G&T) electric cooperative headquartered in Amarillo, Texas. Golden Spread is committed to delivering cost effective, competitive and reliable power to provide a secure energy future for its sixteen member distribution rural electric cooperatives and their retail member-consumers in the ERCOT and SPP. Seven of Golden Spread's sixteen member cooperatives serve retail customers in the ERCOT region. Golden Spread's Members serve over 213,000 retail consumers located in the Panhandle of Texas, South Plains and Edwards Plateau regions of Texas, an area covering twenty-four percent of the state, and in the Panhandle of Oklahoma, and in portions of Southwestern Kansas and Southeastern Colorado.

Golden Spread hopes that the Commission may benefit from Golden Spread's experience in obtaining financing and construction of generating resources as well as its interest in constructing resources in the ERCOT region. Golden Spread is familiar with the capital requirements of new generation. In 2011 alone, Golden Spread finished construction and brought into commercial operation 246 MW of new generation that can provide capacity and energy, a 168 MW quick start gas-fired generating facility at Antelope Station and a 78 MW wind facility at Golden Spread Panhandle Wind Ranch. Golden Spread is constantly reviewing the potential for building capacity to serve in the ERCOT region.

Golden Spread's familiarity with the capital requirements for construction of new generation is important because, as commentators from the financial community confirm, "ERCOT's energy-only market design does not sufficiently incent construction of new generating capacity, as the energy-only market does not provide a stable, predictable source of revenue necessary to obtain construction and permanent debt financing at reasonable cost."⁷ Wholesale market design should promote investment in generating capacity at the lowest reasonable cost. To accomplish this goal, "...lenders must be confident that the borrowing entity will have sufficiently stable net revenues to cover the total amount borrowed with ample margin for error."⁸ If lenders have confidence that there is a secure stream of revenues over the long term to support generation projects, then this confidence should be reflected in lower borrowing costs and ultimately a lower price for retail electricity.

While others have been unwilling to construct generation, municipalities and cooperatives have been building generation in Texas and lowering borrowing costs for their retail consumers. This has been accomplished by offering lenders a secure stream of revenues supported by retail load. Option 4 similarly supports a secure stream of revenues to facilitate lower cost financing. First and foremost, Golden Spread is interested in being sure that the market design in the ERCOT will keep

⁷ Debt Investors Comments at 2.

⁸ Brattle Report at 2.

the lights on. Notwithstanding Golden Spread's arrangements to provide adequate reserves for its load, Golden Spread's ERCOT members are subject to rolling blackouts because the market as a whole does not incent construction of sufficient capacity. Thus, Golden Spread, its ERCOT members and their retail members are adversely affected by the current market structure and urge the Commission to adjust the ERCOT market design to implement mandatory resource adequacy requirements for LSEs.

III. A PROPOSAL FOR OPTION 4 MARKET DESIGN

The Commission has held one workshop to take comments regarding (1) the reliability goal for the ERCOT and (2) whether the goal should be mandatory. These issues were scheduled to be considered by the Commission at its open meeting on August 30, 2012, but were not taken up at that time. If the Commission chooses a reliability target consistent with the ERCOT's implementation of the one event in 10 years standard commonly used in the industry,⁹ the market design in ERCOT will need to be adjusted if it is to provide any assurance of achieving that goal. Although the Commission has increased the high system wide offer cap and some new generation projects have been announced, it is not likely, as the Brattle Report analysis shows, that tweaks to the existing market design or even a \$9,000 offer cap will incent sufficient generation to meet a reliability target that ensures resource adequacy.¹⁰

The Brattle Report describes five market design policy options and recommends that the Commission choose a policy path toward meeting its chosen resource adequacy objectives.¹¹ Golden Spread submits that, among the five market design options presented, the path discussed as Option 4, "Mandatory Resource Adequacy Requirement for LSEs," is the direction that best promotes a secure and efficient long run energy future for ERCOT consumers. As summarized in the Brattle Report,

⁹ In its July 27 Workshop Presentation, ERCOT noted the one day in 10 years standard is used in many other regions (Cal ISO, PJM, NE-ISO, Midwest ISO, and NY ISO), and by FERC for NERC reliability standards. PUC Project 40480; Item 32, *ERCOT's Submission of ERCOT's and the Brattle Group's Presentations, and the Brattle Group's Responses to Entities' Technical Questions to be Addressed at the July 27, 2012, Commission Workshop*, Attachment A, Bates p. 000012. The SPP uses 24-hours-in-10 years standard and a 12% capacity margin, which translates to a 13.636% reserve margin.

¹⁰ The Brattle Report acknowledges that market design policy Options 1, 2 and 3 do not provide a viable long-term solution to ERCOT's resource deficit. In fact, these approaches may add to price volatility and uncertainty, which will not improve the prospects for investment in generating capacity necessary to reliably serve growing demand in the ERCOT region. With respect to Option 1, the Brattle Report finds: "Unless there is a large amount of demand that will curtail voluntarily..., involuntary curtailment in an energy-only market may occur more often than customers, regulators, and policymakers find acceptable. Further, spot prices can be highly volatile...." *Id.* at 105. It notes the "main disadvantage" of Option 2 "is that it does not reliably achieve a particular reserve margin." *Id.* at 106. As for Option 3, the Brattle Report concludes that its disadvantages "are substantial." *Id.* at 109. At the July 27 workshop, Sam Newell representing the Brattle Group pointed out that even with the recent price cap increase to \$4500, there was a lot of uncertainty that the current energy-only market design would support even an 8% reserve margin over the longer term.

¹¹ Brattle Report at 3.

“ERCOT could facilitate an efficient bilateral market for capacity by qualifying resources into a standard, tradable resource adequacy product.”¹²

One way to implement Option 4 would be by leveraging off of the existing systems ERCOT currently operates to manage the Renewable Energy Credits (REC) program. A similar system of “reliability credits” for participant contribution to reserve margin requirements could easily be established. A bilateral ERCOT Resource Adequacy market design incorporating monthly resource adequacy compliance periods would allow the most flexibility for providing incentives to secure long-term financing to develop additional generation resources that can be dispatched in the ERCOT market. Additionally, a monthly compliance program would allow ERCOT the flexibility to manage reserve margin targets through different generation and load situations not only during the peak periods, but also through the shoulder months when maintenance schedules and unseasonable weather can create scarcity. Also, analysis by ERCOT may result in different reserve margin levels during different times of the year. Below is a more detailed proposal incorporating these concepts for designing a market to implement mandatory resource adequacy for LSEs.

While there is a need to be expeditious in implementation, the Commission should at the same time, however, allow the ERCOT sufficient time to observe the Brattle Report’s precaution to not implement market design changes “too quickly or without sufficient analytical support or stakeholder consideration” and to allow market participants “ample time to prepare for the implementation....”¹³ At present, ERCOT market participants make broad use of financially firm products that may or may not be backed up by physical resources. If some form of this proposal is approved this year, then it should be implemented for the summer peak of 2016 to allow LSEs sufficient time to adjust their planning and hedging strategy to meet this new obligation.

It is proposed that the process would be initiated October 1, 2015 and completed by October 31, 2015 for the period of the following December 2015 through November 2016. The resource requirement will be determined for each month of the period.

Qualification of Resources. Each resource nominated must be qualified by ERCOT. It is envisioned that this qualification will create Resource Adequacy Credits (“RAC”) to be administered by ERCOT similar to renewable energy credits. Multiple RAC products may be developed, each with specific performance and price requirements. However, each RAC would represent a MW of qualified capacity. All RAC’s would have the same value for meeting resource adequacy requirements. Generation resources would need to meet capability testing and availability requirements. For demand resources (“DR”), a robust compliance and audit program will be needed,

¹² Brattle Report at p. 112, Bates p. 118. The Report notes, at footnote 231, that “such a system would be similar to the tradable Planning Resource Credit introduced in MISO.”

¹³ Debt Investors Comments, p. 3.

as these resources will likely be counted as reserve most of the time, and will seldom be actually interrupted.

ERCOT Forecast. By September 15, ERCOT will publish the updated load forecast for the following year for December through November. With this forecast and with the administratively determined planning reserve requirement, the resource requirement for the following year will be determined.

Self-Provision of RAC's. By October 15, each LSE in ERCOT will identify the RAC's it will self-provide to meet its projected resource obligation. At this point, each LSE will be responsible for estimating its own resource obligation. Final settlement of this will be as described below.

ERCOT Residual Auction. After receipt of LSE self-arranged resources, ERCOT will aggregate these for each month of the period and determine the amount of additional resources needed to meet the planning reserve obligation. By October 31, ERCOT will then solicit offers from qualified RAC owners, and will use these to conduct a reverse auction to acquire additional RAC's to meet required capacity. This auction will establish a clearing price, and all resources offered at or below the price will be cleared. Any RAC owner that is uncommitted at this point may offer into the auction.

RAC Settlement. RAC settlement for each LSE will be based on its actual load coincident with the ERCOT peak load for each month and its RAC's nominated to ERCOT for the month. In order to reconcile the actual load at the ERCOT peak with the forecasted ERCOT peak, the reserve requirement for each LSE will be the original planning reserve requirement multiplied by the ratio of the forecast ERCOT system resource requirement for the month to the actual ERCOT system resource requirement for the month. System resource requirement is system load (either planned or actual) plus the planning reserve requirement. The LSE modified reserve requirement will be multiplied by its actual coincident peak for the month to determine its resource requirement. Each LSE will be charged the positive difference between this resource requirement and its self-arranged RAC's nominated to ERCOT. This approach should avoid any need for load-ratio-share uplift to LSE's as has been proposed by others.

IV. BENEFITS OF OPTION 4

(a) Option 4 Leverages Off of the Existing ERCOT Market Design and Can be Implemented Quickly

Fundamentally, Option 4 does not necessitate radical changes to ERCOT's current market design. As noted above, the existing renewable energy credits platform can be utilized. This is a huge advantage. The market is already familiar with how to acquire renewable energy credits. A mandatory resource adequacy requirement for LSEs is capable of implementation quickly and at much lower cost than many of the other options. Rapid implementation is important because ERCOT's reserve

margin may be deficient as early as 2014 and it takes a long time to plan, finance and construct new generation. Thus, developers and potential investors need be to know what the rules of the road will be and have additional incentive to construct capacity if they are to begin to address the capacity shortage soon.

(b) Option 4 is Lower Cost

Low cost is also an important feature of Option 4. If Option 4 is implemented in a way that takes advantage of existing market structures such as using the renewable energy credits platform, then Option 4 can be implemented at much lower cost than option 5 which is much more complex and involves establishing a centralized forward capacity market. As the Commission well knows based on ERCOT's experience with implementing a nodal market, significant changes in market design can cost a great deal, and sometimes much more than originally planned.

(c) Option 4 Provides a Clearing Price

The residual ERCOT auction will provide a clearing price for each month of the auction. As stated in the Supplemental Comments of GSO Capital Partners and Stone Lion Capital Partners: "Critical to the success of this market construct however, is the publication and dissemination of resource adequacy clearing prices to all market participants. This will provide an open, transparent and clear signal to developers and financiers regarding the economics of building new generation."¹⁴ This clearing price can also become the basis for bilateral forward trading of resource adequacy products that will allow LSEs to hedge their risk for future years.

(d) Option 4 Provides the Proper Incentives for Lenders and Investors

Most importantly, investors and lenders can easily understand and will appreciate a mandatory system of resource adequacy for LSEs. For years, lenders have been financing construction of new generation for many segments of the market, including for municipalities and electric cooperatives. This financing has been based on a pledge of loan repayment out of revenues derived from retail load. In other words, the lenders are already comfortable with financing projects based on a stream of revenues to be received from retail customers, much like the pledge that a resource entity might give if mandatory resource adequacy for LSEs is adopted. The comments of lenders strongly suggest they will finance new construction if Option 4 is implemented. For example, the supplemental comments of GSO Capital Partners and Stone Lion Capital Partners urge the Commission to "consider steps to further evaluate and potentially implement a market design structure largely in the form of the Brattle Group's Option 4." The commenters note that "... a resource adequacy requirement for LSEs would function to establish long-term market prices among participants and provide the necessary economic incentives for LSEs to procure adequate resources, thereby supporting the ability to finance future generation capacity and providing the revenues needed to sustain existing and new generation."¹⁰ In

¹⁴ Debt Investors Comments, at 3.

short, Option 4 as proposed with self-arrangement and a residual RAC market provides the incentives developers need to construct new generation and the stable and predictable stream of revenues that lenders need to finance projects.

IV. Option 4 Is Different from and Does Not Present Many of the Problems Associated with Option 5.

Option 5 involves establishing a centralized forward capacity market in ERCOT. Adoption of this approach would be a radical departure from the existing energy only market in ERCOT and would require the establishment of complex rules for how a capacity market would operate. Even if such a market were to be established, it is likely that it will be imperfect and subject to gaming or manipulation. GSO Capital Partners and Stone Lion Capital Partners note that centralized capacity market designs “have been established through implementation of complicated rules that even if arguably designed correctly, have led to problematic implementation issues, subversion, potential manipulation of market rules, and protracted litigation.”¹⁵ In Golden Spreads view, establishing a centralized forward capacity market would require significant changes to the energy only nodal market design structure. The process to develop this will be very costly, requiring huge support from vendors and stakeholders in the redesign activity. Additionally, ERCOT and the market participants would have to change their systems and go through market trials to fix problems and ensure a smooth transition to a capacity market structure. Embracing Option 4 would eliminate all of this additional time and expense, and allow the ERCOT energy market to function as it does today.

V. CONCLUSION AND PRAYER

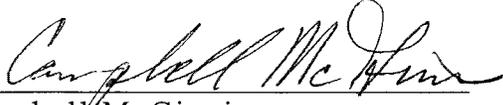
Golden Spread respectfully requests that the Commission direct the ERCOT to begin working to implement an Option 4 solution consistent with these comments. Option 4 will ensure achievement of an appropriate target reserve margin in the ERCOT, help attract lower cost financing, and is consistent with the established bilateral contracting, competitive, market-based processes already developed within the ERCOT. It can be developed more quickly and at a lower cost than Option 5 and without inviting many of the problems associated with Option 5. As the Brattle Report concluded: “If policy makers decide that a higher target reserve margin must be met every year, imposing a resource adequacy requirement on LSEs is the most market-based efficient option.”¹⁶

¹⁵Supplemental Comments of GSO and Stone Lion, p. 4.

¹⁶Brattle Report at 6.

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