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PUC PROJECT NO. 40000

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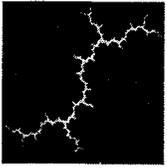
AARP COMMENTS ON BRATTLE COMPOSITE OPTIONS

AARP appreciates the opportunity to file these comments regarding ERCOT resource adequacy. These comments supplement AARP's comments submitted on July 29, 2012 in Project 40268 and comments filed in Project 40000 on September 10, 2012. AARP has engaged Synapse Energy Economics, Inc. to analyze the two Brattle composites. Synapse's analysis is attached.

Respectfully submitted,

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**Assessment of the Brattle Composite Options and
ERCOT Reserve Margin Analysis Update**

Prepared for AARP

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November 2, 2012

Introduction

These comments supplement the comments provided by AARP on September 10, 2012, in this proceeding and on July 29, 2012, in Project 40268. On behalf of AARP, we reviewed the Brattle Group's October 25 presentation on the two composite options, ERCOT's updated report on its reserve margin analysis, and the many comments of interested parties to these PUCT proceedings.

As stated in its earlier comments, AARP supports analyzing the cost to consumers of any proposed changes to the current market structure in Texas. Given the narrowing of the many options discussed in the June 2012 Brattle Report to the two composites in Brattle's most recent filing and the more optimistic reserve margin analysis provided by ERCOT, the task of identifying and quantifying the costs to consumers of each option should be manageable. Assuming that each option should be designed to achieve the same reliability target, it would be useful to compare the estimated costs of each option to achieve that target. In simple terms, as stated at the workshop on October 25 by the Brattle Group's Sam Newell, the goal is to determine what option provides good (reliable) service at the least cost.¹

ERCOT Reserve Margin Analysis Update

On October 22, ERCOT filed an update to its filing of September 19, 2012. The September filing updated ERCOT's May 2012 Capacity, Demand, and Reserves (CDR) Report by including some announced generation additions. ERCOT will file an additional, full update of its May CDR Report in December 2012 that will include a revised economic forecast. The significance of the most recent update is that ERCOT provided a reserve margin analysis using Moody's low economic forecast from spring 2012. The May 2012 CDR report and the September update both used Moody's base economic forecast. ERCOT believes that Moody's low forecast will be closer to the new economic forecast it will use for the December 2012 CDR report.

¹ Brattle Presentation, October 25, 2012, p.5 as summarized by Sam Newell.

Moody's low forecast from May 2012, when combined with generation additions from the September update, produces an increase in the anticipated reserve margins for future years. Attachment A to the October 22 filing shows the increases for the years 2013-2018. The variance between the May 2012 estimated reserve margins and the October 2012 estimated reserve margins is substantial. The May 2012 report estimates a 2013 reserve margin of 14.3% that decreases to 5.8% in 2018.² The October 2012 update estimates a 2013 reserve margin of 16% that decreases to 10.4% in 2018.³

The significance of the increased reserve margin estimate is two-fold. First, it underscores the variability in any process that forecasts future loads and resources; the uncertainty in all forecasts is real and each forecast needs to be tempered with that knowledge. Second, the estimated increases in reserve margins provide support for a cautious and deliberate process for addressing changes to the current market structures. Not an unlimited extension of time, but some increased flexibility for evaluating potential changes in greater detail and to develop some estimates of costs to consumers for each of the two composite options.

The criteria for including announced resource additions and the proper categorizing of mothballed resources may benefit from additional discussion, too. The Public Utility Commission should require the December 2012 CDR Report to provide a thorough explanation of what resources have been included and the standards for inclusion and exclusion.

Finally, we note that ERCOT is skeptical that implementation of either of the Brattle Composite options can be accomplished in six months.⁴ For the Texas Capacity Market option, we share ERCOT's concern based on our ten years of experience with market structure changes in PJM and ISO New England, including their respective capacity market structures (RPM and FCM).⁵ The Energy Market with DR Support option may have a shorter implementation schedule, at least for the DR elements that build upon existing ERCOT structures. However, the more extensive DR penetration from residential and small commercial customers that will be needed to achieve long-term reliability may be more complex, controversial, and costly, thereby extending the implementation schedule for this option as well.

Brattle Composite Options

From the five options presented in the June Brattle Report, Brattle's presentation for the October 25 workshop, along with supplemental materials, discussed two composite options that reflected extensive discussions with numerous stakeholders, as well as review of the written comments filed in this proceeding. Brattle emphasized that regardless of recent or future changes in reserve margin estimates based on new generation, adjusted load forecasts, imminent retirements, or combinations of all three,

² ERCOT Updated Report, 10-22-12, Attachment A, line 4.

³ *Id.* line 7.

⁴ ERCOT Updated Report, 10-22-12, page 4.

⁵ PJM's Reliability Pricing Model was the subject of two years of stakeholder discussions prior to the appointment of a FERC settlement judge. ISO New England experienced a similar lengthy stakeholder and FERC settlement process for its Forward Capacity Market design.

the fundamental flaws of an energy-only market will persist until large quantities of dispatchable demand resources actively participate in the energy market.⁶

Energy Market with Demand Response Support

At the start, this option retains the existing market structures and seeks a way to increase current demand response programs (ERS, TDU programs, competitive provider programs, etc.). This option will also explore and develop new opportunities for responsive demand (voluntary smart meter enabled price responsive demand such as Peak Time Rebates, direct load control programs, new technology enabled response, etc.).

The ability to start right away by expanding the ERS program and removing barriers to additional utility programs (barriers such as investment costs for meters, controls, and communications), makes this composite option attractive. The gradual increase in costs to support greater demand response participation can also be scaled back in future years as price responsive demand becomes more cost-effective and more automatic (without the need of special payment programs).

Brattle also notes that an increase in the reserve requirement can be utilized on an interim basis as a way to force additional scarcity pricing signals to attract new investment (and increase the total quantity of available resources). This option reinforces the need to consider the cost to consumers of these multiple approaches to reaching the target reserve margin. The payment price to ERS program resources, the maintenance of energy market price signals when the ERS program is utilized, and the potential for an increase in scarcity hours (through a higher reserve requirement) are issues that will require consideration as a package of costs relative to the reserve margin target. There may be trade-offs among the several demand response and related options that could be utilized.

Brattle asserts that aggressive support for demand response will accelerate its development and create a possible ideal energy-only market with active demand resources.⁷ The projected near-term decreases in reliability reserve margins that triggered this proceeding now appear to be not quite as imminent. Thus, the timeframe for achieving greater demand response participation may be longer than first thought. We conclude that further discussion of the details for this composite option is appropriate and needed.

Texas Capacity Market

This option adapts the general framework of a PJM-style three-year-forward capacity market to the current energy market.⁸ The fundamental concern with this option is the complexity of developing a mandatory, full-requirements, forward capacity structure.

⁶ Summary of Sam Newell comments at October 25 workshop. The "sufficient quantity" of DR is unknown, but to be effective, the demand response resources would need to participate in the real-time energy market on a dispatchable basis (short-term), over many hours, and in adequate quantities to affect the supply curve price on an hourly basis.

⁷ Brattle Presentation, 10-25-12, page.8.

⁸ Id., page 19.

Brattle proposes a single-zone, plain vanilla version that reduces some of the initial design complexity, but it may also reduce the utility of this approach over the long term.⁹ A non-locational clearing process is simple, but it does not provide discrete (and useful) price signals for load pockets or other stressed elements of the overall Texas power system.

The shape of the demand curve, the need for a minimum offer rule, the relationship to scarcity pricing in the energy market, and cost allocation will require proceedings to evaluate alternative options and packages of options. And, as noted in earlier AARP comments, there needs to be some certainty that new capacity resources will actually get built. ERCOT's revised CDR report in December is likely to show a significant increase in reserve margins for the 2013-2018 period. For the critical 2016 delivery year, reserve margins may be 12.0%, close to historic averages.¹⁰ If the window for designing and implementing structural market changes is three years from this spring of 2013, then there should be time to develop more details about this Brattle composite, including an estimate of cost to consumers.

Summary

Both of the Brattle composite options need more detailed development to determine what option is likely to be the most cost-effective option to ensure a reliable system. As those details are developed, there are certain key variables that need to be thoughtfully and transparently identified.

- What is the reserve margin that will maintain an adequate reliability standard? Is it 12%; 13.75%, 15%, or some other value?
- What are the specific components of the energy and peak load forecasts? Economic forecasts, resource forecasts (including new and mothballed units), and sensitivity analysis.
- What quantities of DR are attainable? What types of incentives and support are appropriate; application to existing programs, expanded programs, and new programs that can be developed within three years?
- What mechanism(s) will be used to ensure integrity of energy market prices? Thresholds for scarcity pricing, increased reserve requirements, or other.

Clearly identifying the assumptions about these variables will assist in the cost analysis of both composite options and provide a reasonable common platform for comparison.

⁹ An important consideration is the evolution of markets in New England with a single price energy market evolving to multiple-zone locational prices. The initial capacity market design (FCM) was a single zone with constraints that is now transitioning to a multi-zone locational capacity market. Yes, markets can evolve, but an initial, complete design is less costly and less disruptive.

¹⁰ ERCOT Updated Report, Attachment A, line 27.