



Control Number: 24770



Item Number: 249

Addendum StartPage: 0

Public Utility Commission of Texas

Memorandum

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PUBLIC UTILITY COMMISSION
FILING CLERK

TO: All Parties of Record

FROM: Commissioner Brett A. Perlman

RE: Docket No. 24770– Report of the Electric Reliability Council of Texas (ERCOT) to the PUCT Regarding the ERCOT Protocols.

DATE: June 6, 2003

I am filing a letter from Falcon Gas Storage in the record of this proceeding. While the letter has Docket No. 24770 as its subject, it appears that the letter focuses on certain observations about natural gas deliverability in the Report by the Commission's Market Oversight Group on the price spikes experienced in the market on February 24-26, 2003, Project No. 25937. I understood that the Staff filed this report in Docket No. 24770 because the report discussed solutions to market operation problems at issue in this case. The natural gas delivery issues, while important, are not the contested issues addressed in this proceeding.

While the letter does not appear to touch on the contested issues in this proceeding, I wanted to file this letter so parties have the opportunity to review this communication.

249



June 3, 2003

Mr. Brett Perlman, Commissioner
Public Utility Commission of Texas
1701 N. Congress Avenue
Austin, Texas 78701

RE: Docket No. 24770, Report of the Electric Reliability Council of Texas (ERCOT) to the Public Utility Commission Regarding Implementation of the ERCOT Protocols (the Report).

Dear Commissioner Perlman:

I have read with great interest the captioned Report prepared by the Market Oversight Division (MOD). In particular, I was struck by the conclusions reached with respect to the inability of the natural gas delivery infrastructure in Texas to respond to the needs of gas-fired power plants during the extreme weather conditions that occurred this past winter.

For the last three years, Falcon Gas Storage Company has been advocating the use of high-deliverability, multi-cycle (HDMC) gas storage facilities to meet the real-time gas supply needs of gas-fired power plants. Falcon already has developed and operates an HDMC gas storage facility (Hill-Lake) that can serve gas-fired power plants located in the north zone of ERCOT. Further enhancements to the existing HDMC capabilities of Falcon's Hill-Lake Gas Storage Facility are underway in order to meet the increased demand for HDMC storage services this coming winter. Falcon also is planning to retrofit a second gas storage facility (Worsham-Steed) for HDMC service that is located just outside of the Dallas-Ft. Worth metroplex.

During the period from February 24-26, 2003 when gas deliverability in Texas was in fact severely constrained, Falcon's Hill-Lake Gas Storage Facility delivered its full contract quantities of gas inventory to all firm customers, at least two of which were directly serving gas-fired power plants in Texas. Falcon's Hill-Lake Facility is strategically located to serve several thousand megawatts of gas-fired generation capacity located along Lone Star Pipeline's "Line X" and El Paso Gas Transmission's North Texas Pipeline, which are the two major west-to-east gas transmission pipelines serving the north Texas market. Another several thousand megawatts of gas-fired generation capacity serving the Dallas-Ft. Worth metroplex are located within a 50-mile radius of Falcon's Worsham-Steed Gas Storage Facility, including one newly-

constructed 800 MW power plant that is less than 10 miles away. All of this gas-fired generation capacity could easily be served by the Worsham-Steed Facility.

With all due respect to the findings of the Market Oversight Division, Falcon submits that neither a curtailment methodology for natural gas mandated by the Railroad Commission nor financial incentives for maintaining fuel oil inventories is the answer to the gas deliverability challenges that were brought to light this past winter. *The problem is a lack of sufficient gas deliverability infrastructure in Texas -- and indeed throughout the United States.*

Specifically, there is a lack of sufficient natural gas storage deliverability to meet peak-day requirements both during winter *and* summer peak-day demand periods. And the situation will only get worse as more gas-fired generation capacity is brought on line. Simply curtailing deliveries to industrial gas consumers will not solve this problem, nor will providing financial incentives to the owners of out-dated, inefficient dual-fuel power plants to maintain costly fuel oil inventories, especially when more environmentally sound alternatives already exist.

In lieu of the recommendations set forth in the Report, Falcon respectfully suggests that the Public Utility Commission and the Railroad Commission should strongly consider the following measures in order to ensure a real-time cost-effective supply of natural gas deliverability to meet the unique gas supply needs of the gas-fired power industry in Texas:

- Streamline the regulatory approval process for developing HDMC gas storage facilities that can readily serve gas-fired power plants in Texas -- especially existing gas storage facilities that can be retrofitted for HDMC service.
- Provide incentives for gas-fired power plants to directly access HDMC gas storage facilities where direct pipeline interconnections are feasible. This is the most reliable cost-effective way to access the real-time deliverability afforded by strategically-located HDMC gas storage facilities.
- Where direct interconnects between gas-fired power plants and HDMC gas storage facilities are not feasible, strongly encourage (if not mandate) third-party pipelines that are interconnected with both HDMC gas storage facilities and gas-fired power plants to implement changes in their operating terms and conditions (as set forth in their tariffs on file with the Railroad Commission) to accommodate the needs of gas-fired power plants. These changes should facilitate the real-time nomination and dispatch of gas supply from HDMC gas storage facilities to respond to the real-time needs of gas-fired power plants to access the gas supply deliverability and reliability that is in fact available from HDMC gas storage facilities.
- Take immediate steps to ensure that the Public Utility Commission and the Railroad Commission both recognize and are willing to preserve the "sanctity of

contract" between the providers of gas supply deliverability and the recipients thereof (including gas-fired power plants and their fuel suppliers) who have freely and willingly entered into negotiated contracts for gas supply and/or gas deliverability, including gas storage services.

Contrary to the assertions of the IPPs interviewed by MOD, the cost of an HDMC gas storage service tailored to meet the gas supply needs of new (as well as older) gas-fired power plants would add less than 5% to the annual cost of gas supply for a typical gas-fired generation facility at today's gas prices. This is a far more economical solution than curtailing gas deliveries to industrial shippers or maintaining fuel oil inventories for outdated, inefficient dual fuel generating facilities. It also pales in comparison to the price run-up for balancing energy in ERCOT during this past winter.

Falcon believes very strongly that the implementation by the Public Utility Commission and the Railroad Commission of the measures enumerated above will ensure that the gas-fired power industry in Texas will have ready access to a reliable, cost-efficient source of real-time gas supply deliverability. Implementation of these measures will greatly diminish, if not eliminate all together the likelihood of a repeat of the events that transpired during February 24-26, 2003 and will obviate the need for having to resort to more costly, less environmentally sound alternatives.

Falcon would be happy to meet with members of both the Public Utility Commission and the Railroad Commission at any time to answer any questions and further describe the nature of the HDMC storage services that are currently available to increase the reliability of fuel supply for gas-fired power plants. We appreciate your attention to this very important subject and look forward to the prospect of meeting with you soon.

Respectfully submitted,



John M. Hopper
President and CEO

cc: The Texas Railroad Commission
Hon. Michael L. Williams, Chairman
Hon. Charles R. Matthews, Commissioner
Hon. Victor G. Carrillo, Commissioner