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**LOWER COLORADO RIVER AUTHORITY'S COMMENTS ON REPORT ENTITLED
"BACK CAST SOLUTION OF INTERIM SOLUTION B+ TO IMPROVE REAL-TIME
SCARCITY PRICING"**

The Lower Colorado River Authority (LCRA) offers the following comments in Project No. 40000 – *Commission Proceeding to Ensure Resource Adequacy in Texas*, relating to the white paper entitled "Back Cast Solution of the Interim Solution B+ to Improve Real-Time Scarcity Pricing" prepared by Prof. William Hogan and filed by the Electric Reliability Council of Texas (ERCOT) on March 22, 2013 and supplemented with additional analysis on May 3, 2013 (together called Solution B+). On April 3, 2013, the Public Utility Commission (PUC) requested comments on Solution B+ and the back cast analysis.

LCRA General Comments on Solution B+

LCRA believes that incorporating an operating reserve demand curve into ERCOT's scarcity pricing model could provide more effective price signals to the market. In addition, LCRA observes that Solution B+ is based on sound economic principles and may be a logical step in refining the current energy-only market design.

ERCOT has completed an impact analysis and expects that implementation of Solution B+ could cost \$200,000 and take eight months to complete. LCRA believes that implementation of Solution B+ would not be excessively costly or time consuming. Nevertheless, Solution B+ will not be in place for this summer and it is considered "interim" in nature.

LCRA believes that efforts should instead be focused on moving forward with other longer term solutions that may be more effective in addressing resource adequacy. In its previous filings in Project No. 40000, LCRA commented that: 1) reliability and encouraging new generation investment in ERCOT are the paramount concerns; 2) a gradual approach to price increases

brought on by scarcity events is preferable; and 3) extreme price volatility and risk exposure brought on by increasingly frequent scarcity events coupled with higher energy offer caps is detrimental to the market. Solution B+ appears to promote more gradual price increases as scarcity events occur, yet it may lead to more frequent scarcity pricing events depending on the level at which the contingency reserve is set. Further, credit impacts and market risk exposure should be a factor in understanding the impact of Solution B+. The back cast does not speak to this concern. More importantly, it is not clear to LCRA that Solution B+ will encourage new generation investment in ERCOT to bolster reserve margins and create a more reliable electricity supply for ERCOT ratepayers.

More specifically, the back cast uses data that may not be indicative of a typical year, does not account for market participant behavioral changes that would certainly arise if the solution were implemented, and does not adequately account for market design changes that have been recently implemented. The years 2011 and 2012 captured extreme variances in the weather between exceptionally high and low temperatures in 2011 and relatively mild conditions in 2012. ERCOT's back cast essentially offers broad "bookend" estimates of high and low expectations for additional net revenues to generators under Solution B+. LCRA offers that the back cast indicates such a wide range of predicted outcomes that it is difficult to draw conclusions as to what the impact of the implementation of Solution B+ may be in forward periods. Additionally, because the back cast is simply an overlay of new prices on historic plant dispatch and market participant activity, it does not account for the obvious operational and strategic behavioral changes that would occur.

This back cast as a prediction of Solution B+ market impacts also is complicated by the market design changes implemented *since* the back cast period of 2011 and 2012, such as the increases to the system-wide offer cap and the implementation of price floors and higher procurement quantities for certain ancillary services. In other words, despite the results of the back cast study, uncertainty remains as to how Solution B+ may compare to the current market design parameters. Ultimately, if the goal of Solution B+ is to create a price adder that addresses the "missing money" problem, then the contingency reserve level may need to be set higher than in the current market.

Further, the back cast estimates are sensitive to the Value of Lost Load (VOLL) as well as other variables. Market participants have yet to see the results of ERCOT's VOLL study that is currently underway and this creates additional uncertainty around the impact of Solution B+.

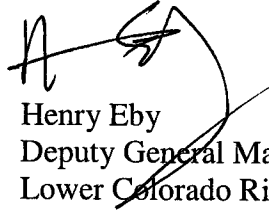
Market participants have pointed out limitations of the back cast methodology including the shape of the operating reserve demand curve (piece-wise linear versus a continuous curve), what the minimum contingency level should be (1,375 MW versus 2,300 MW), and the frequency with which the curve may be changed. These fundamental concerns raise questions about whether the estimates of additional net revenues to generators may be overstated, and whether the solution will provide enough certainty to incentivize additional investment. Solution B+ may well be an effective approach to scarcity pricing; however, LCRA believes that the proposal should be viewed in the context of how it may address resource adequacy in ERCOT.

LCRA Recommendation

LCRA recommends that additional analysis be performed by the Brattle Group on the impact of Solution B+ to address resource adequacy in ERCOT. Specifically, the Brattle Group could be asked to refresh its research, originally included in its report published in June 2012, on how the investment community views current ERCOT market conditions and how market design proposals under consideration, such as Solution B+, may be effective in incentivizing new generation investment in ERCOT. In the same study, Brattle Group could also be asked to model the effects of Solution B+ in forward periods incorporating the increases in the system-wide offer cap and the implementation of price floors and higher procurement quantities for certain ancillary services.

LCRA appreciates the opportunity to comment on the Solution B+ proposal, and looks forward to participating in the workshop. LCRA supports the PUC's actions to address resource adequacy issues and will continue to work with the PUC, ERCOT and market participants to find appropriate approaches to encourage investment in new generation in ERCOT.

Respectfully submitted,

A handwritten signature in black ink, appearing to be 'H Eby', with a large, sweeping flourish extending from the end of the signature.

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