

THE NATURE OF ERCOT'S CAPACITY RESERVE MARGIN

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**PRESENTATION FOR RESTRUCTURING
TODAY WEBINAR**

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ERCOT Market Design

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- ERCOT has an “Energy-only Market” wholesale market design. Owners of generation are only paid for the electricity they actually put out on the grid, unlike the other restructured markets in the United States.
- The two exceptions to this rule are the capacity payments that are part of the daily bids to provide ancillary services and emergency response service (loads and generators available for deployment in an electric grid emergency procured through bidding four months in advance), which are the reliability and operational resources used to maintain grid stability that ERCOT procures from generation and load resources, and beginning June 1, 2014, payments from the Operating Reserve Demand Curve.

Problems with a Mandatory Capacity Reserve Margin

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- Currently ERCOT has a 13.75% “target” capacity reserve margin.
- Why is the *nature* of ERCOT’s capacity reserve margin important?
 - If ERCOT retains a “target” capacity reserve margin it is of relatively lower importance because it only is a signal to generation investors of when to build. It is also the reason that ERCOT’s load forecasts have not, until recently, received much scrutiny.
 - If ERCOT adopts a “mandatory” minimum capacity reserve margin, it becomes very important because it drives the amount of generation procured either in forward capacity auctions or some other process and translates into dollars imposed on consumers.
- A mandatory capacity reserve margin will result in billions of unnecessary, unavoidable and largely un-hedgeable costs to customers, without guaranteeing rolling blackouts will not occur.

Problems with a Mandatory Capacity Reserve Margin: Likely to Lead to Unrealistic Expectations

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- ERCOT has NEVER experienced a grid collapse, unlike many other parts of the country.
- There have been two ERCOT involuntary rotating load-shed events to avoid grid collapse:
 - **April 2006:**
 - Had a 16.4% capacity reserve margin;
 - A heat related event;
 - A large number of generation units were down for planned maintenance; and
 - Wind dropped off unexpectedly.
 - **Feb. 2011:**
 - Had between 15.9% and 17.5% capacity reserve margin;
 - A cold weather event.
- And, in the **winter of 1989**, before ERCOT was the balancing authority, and local vertically integrated electric utilities were their own balancing authority Houston Power and Light had to initiate rolling blackouts to maintain their system because of weather related gas curtailments and generation outages, even though they had a **capacity reserve margin of over 30%.**

Points to Consider

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- Tight reserve margins more than 3 years out are to be expected in an efficient Energy-Only market that exists in a state or region that is experiencing continued economic growth and increased electricity consumption.
- It is VERY important to remember that normal system planning and the resulting installed capacity reserve margins do not avoid the risk of rolling blackouts from ‘black swan’ events – events that occur outside of reasonable planning criteria.
- If we adopt a mandatory reserve margin there is the danger of creating unrealistic expectations; particularly if we were to go to a centralized forward capacity market construct.

ERCOT Has Seen Forecasted Tight Capacity Reserve Margins Before

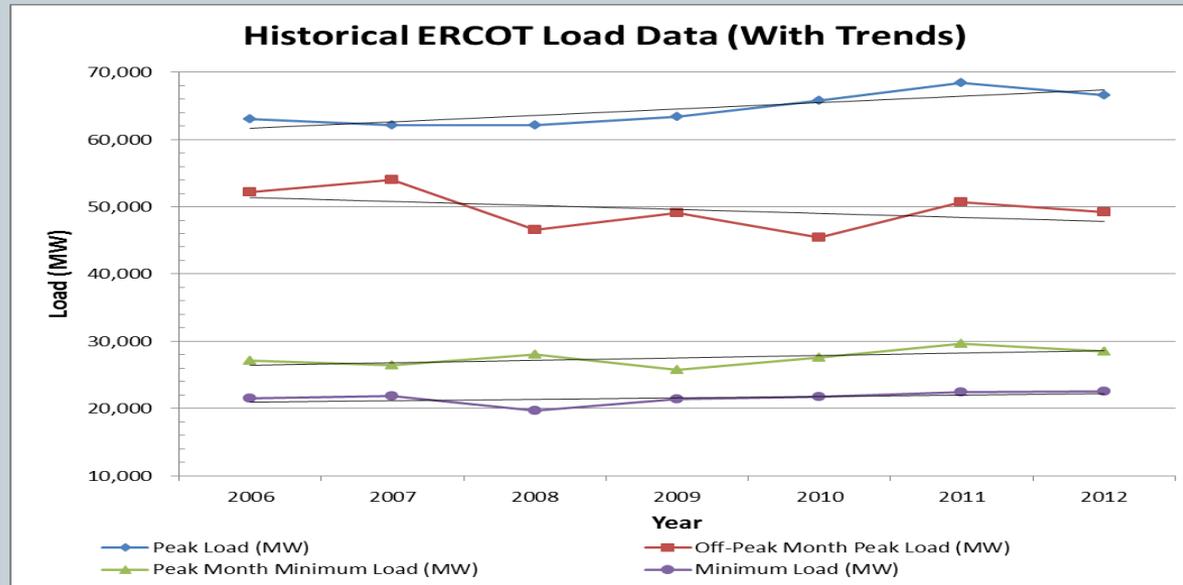
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- Summer of 1998. Very hot, tight summer. Severe concerns about reserves.
- June 2005 Report on Capacity, Demand and Reserves in the ERCOT Region (CDR) showed inadequate reserves by 2010.
- June 2006 CDR showed inadequate reserves by 2008.
- May 2008 CDR showed inadequate reserves by 2013.
- May 2009 and 2010 CDRs showed adequate reserves through at least 2014.
- An efficient energy-only market with growing consumption should always show a capacity reserve margin shortfall 4-5 years out.

The REAL Scope of the Problem: ERCOT does not need more Base Load Generation

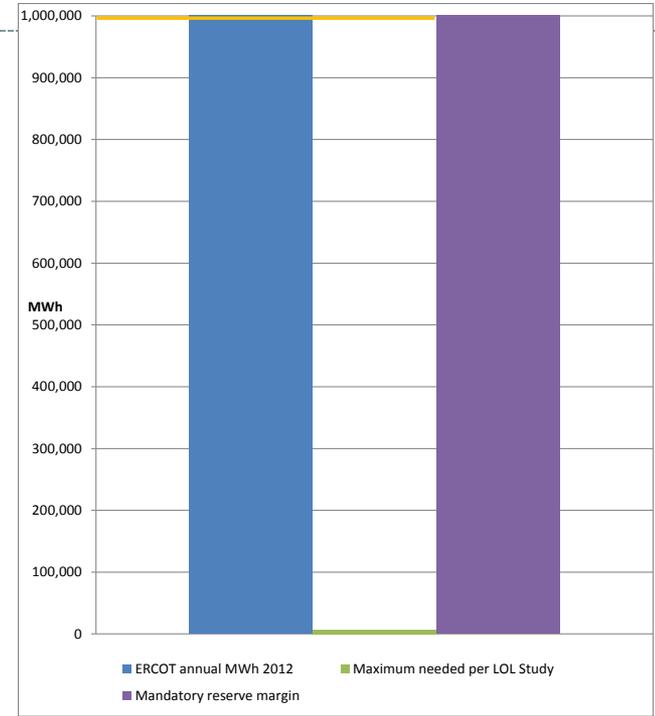
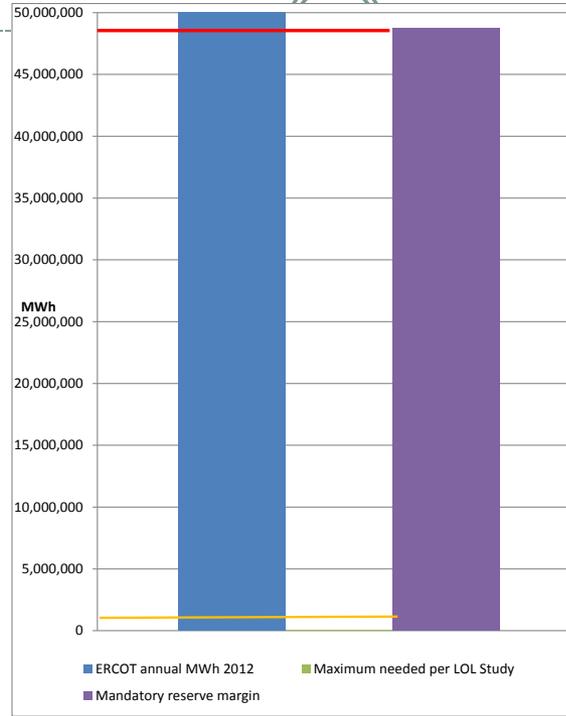
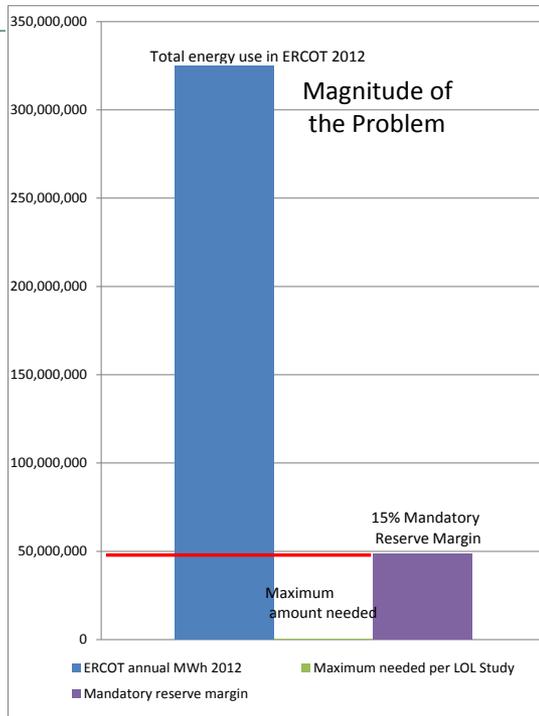
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- ERCOT's high low load trend is relatively flat, so ERCOT has sufficient base load generation.



- ERCOT's Resource Adequacy "problem" actually is only an issue of 160 hours during the summer, out of 8760 total hours per year. (< 2% of the time)
 - 4 hours per day x 5 days per week x 8 weeks per year.
 - And this is probably an inflated number, the real problem likely is less than 80 hours a year.
 - In July 2011, there were no intervals where reserves dropped below 2000 MW.
 - In August 2011, there were a total, but non-continuous, 4.68 hours when reserves fell to a level just above involuntary load curtailment. No load was involuntarily curtailed.

Capacity Market Advocates Say Buy the Purple to Cover the Green



These graphs show how small the problem is relative to how much generation capacity market advocates say must be purchased to increase reliability 0.00219%. The graphs zoom in from left to right, note the common marking lines. The first slide shows how many MWh were consumed in ERCOT in 2012, what the mandatory reserve margin would be at 15%, and in the center column, the maximum amount of incremental generation capacity that would be required in 2016. Setting a mandatory reserve margin at 15% would require the purchase of the purple column, in order to cover *possible* outages of the green column. If we use the capacity payment from the PJM market in 2012 of \$6.02/MWh (total consumed), the total cost would have been \$6.02/MWh x 324.859 million MWh (total consumed in ERCOT) = \$1.956 billion/year. Requiring a mandatory reserve margin of 15% in 2012 would have resulted in the \$1.956 billion purchase of 48.73 million MWh extra (the purple column) in order to protect against the *possible* outage of 1,500 MW for 4.73 hours spread out over the *entire* year (the green column).

If in the remote possibility that the capacity shortfall represented by the green column were to occur in 2016, ERCOT's reliability would still be 99.998%. The capacity market advocates say we need to spend \$1.956 billion annually to solve a *potential* 0.00219% reliability problem.

Other Problems with a Mandatory Reserve Margin and a Capacity Market

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- Does the Public Utility Commission of Texas (PUCT) have the legal authority to establish a mandatory reserve margin or capacity market in ERCOT?
- If a mandatory reserve margin were established and a capacity market were to be mandated, what entities would be required to participate and how would the cost of the capacity market be allocated?
 - The PUCT has limited authority over cooperatives and municipal utilities.
 - Can the PUCT force cooperatives and municipal utilities to participate in a capacity market, or even force them to maintain a mandatory reserve margin?

TABLE OF ANNUAL PER METER COST DEPENDING UPON ANNUAL COST OF A CAPACITY MARKET AND PARTICIPATION FROM MUNICIPALITIES AND coopERATIVES WITH GENERATION

Cost of Capacity Market/yr \$ billion/yr	For costs of Capacity market			\$/meter (no munis or coops)
	\$/meter (all meters)	\$/meter (no munis)	\$/meter (no coops)	
\$6.0	\$594.06	\$720.29	\$700.12	\$882.35
\$5.6	\$554.46	\$672.27	\$653.44	\$823.53
\$5.2	\$514.85	\$624.25	\$606.77	\$764.71
\$4.8	\$475.25	\$576.23	\$560.09	\$705.88
\$4.4	\$435.64	\$528.21	\$513.42	\$647.06
\$4.0	\$396.04	\$480.19	\$466.74	\$588.24
\$3.6	\$356.44	\$432.17	\$420.07	\$529.41
\$3.2	\$316.83	\$384.15	\$373.40	\$470.59
\$2.8	\$277.23	\$336.13	\$326.72	\$411.76
\$2.4	\$237.62	\$288.12	\$280.05	\$352.94
\$2.0	\$198.02	\$240.10	\$233.37	\$294.12
\$1.6	\$158.42	\$192.08	\$186.70	\$235.29

Public Utility Commission Authority

- The PUCT derives its authority from the legislature exclusively and may only act pursuant to delegations of authority granted in statute, which primarily appear in the Public Utility Regulatory Act (PURA).
- The PUCT may not undertake action that contradicts specific statutory language of PURA or frustrates the overall objectives of PURA.

SOURCES OF PUCT AUTHORITY

- PURA § 39.151(d) – “The commission shall adopt and enforce rules relating to the reliability of the regional electrical network . . . or may delegate to an independent organization responsibilities for establishing and enforcing such rules” and the PUCT maintains complete oversight authority to ensure that ERCOT performs its obligations under PURA.
- PURA § 39.151(a)(2) – The independent organization (ERCOT) must “ensure the reliability and adequacy of the regional electrical network.”

PUCT Sources of Authority – Ancillary Services

- PURA § 35.004(e) – “The commission shall ensure that ancillary services necessary to facilitate the transmission of electric energy are available at reasonable prices with terms and conditions that are not unreasonably preferential, prejudicial, discriminatory, predatory, or anticompetitive.”
- PURA defines “ancillary services” as services necessary to facilitate the transmission of electric energy including load following, standby power, backup power, reactive power, and any other services as the commission may determine by rule.

Statutory Limitations on PUCT Authority

PURA'S POLICY DECLARATION

- PURA § 39.001(a) – “The legislature finds that the production and sale of electricity is not a monopoly warranting regulation of rates, operations, and services and that the public interest in competitive electric markets requires that . . . electric services and their prices should be determined by customer choices and the normal forces of competition.”

MANDATE AGAINST INTRUSIVE REGULATION

- PURA § 39.001(d) – “[The PUCT] . . . shall authorize or order competitive rather than regulatory methods to achieve the goals of this chapter to the greatest extent feasible and shall adopt rules and issue orders that are both practical and limited so as to impose the least impact on competition.”

PUCT Authority Over Municipal Utilities and Electric Cooperatives

- PURA § § 40.004 and 41.004 restrict the PUCT’s jurisdiction over municipal utilities and electric cooperatives to a specific set of purposes. None of the listed purposes expressly allow the PUCT to require a municipal utility or electric cooperative to fund a resource adequacy mandate. However...:
- PURA § 39.151(j) – “A . . . municipally owned utility [or] electric cooperative . . . shall observe all scheduling, operating, planning, reliability, and settlement policies, rules, guidelines, and procedures established by the independent system operator in ERCOT.”
- Municipal utilities and electric cooperatives would likely be subject to a resource adequacy mechanism to the extent that any such mechanism is implemented through ERCOT reliability rules, guidelines, or procedures relating to the operation of the day-ahead and real-time market.