PROJECT NO. 37897

PUC PROCEEDING RELATING TO RESOURCE ADEQUACY AND RESERVE ADEQUACY AND SHORTAGE PRICING	**§ § § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ADOPTING NEW §25.508 AS APPROVED AT THE JUNE 28, 2012, OPEN MEETING

The Public Utility Commission of Texas (commission) adopts new §25.508, relating to High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region with changes to the proposed text as published in the April 27, 2012 issue of the *Texas Register* (37 TexReg 2955). The rule increases the high system-wide offer cap (SWOC) applicable to resources in the Electric Reliability Council of Texas (ERCOT) market to ensure that the price signals in the ERCOT market are adequate to maintain continuous electric supply. This rule is a competition rule subject to judicial review as specified in Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (West 2007 and Supp. 2011) (PURA) §39.001(e). This new section is adopted under Project Number 37897.

The commission received comments on the proposed new section from Senators Rodney Ellis and Wendy Davis, Representatives Sylvester Turner and Rafael Anchia, Ambit Energy and of Stream Energy (Ambit and Stream), and Texas Christian University (TCU), Blue & Silver Energy Consulting LLC (Pro-Star), City of Austin (Austin Energy), City of Houston, CPS Energy (CPS), Consolidated Edison Solutions, Inc. (ConEd), Direct Energy LP (Direct Energy), Group of Competitive Texas Power Suppliers (CTPS), IPR-GDF SUEZ Energy North America Inc. (IPR-GDF SUEZ), William Leek, Lone Star Chapter of Sierra Club (Sierra Club), Luminant, MidAmerican Energy Company, NRG Energy (NRG), Odessa-Ector Power Partners (Odessa-Ector), Office of Public Utility Council (OPUC), Public Citizen, South Texas Electric Cooperative (STEC), Steering Committee of Cities Served by Oncor and the Texas Coalition for Affordable Power (Oncor Cities), and Texas Association for Energy Marketers (TEAM), Texas Competitive Power Advocates (TCPA), Texas Industrial Energy Consumers (TIEC), Texas Power LP Solutions (Texas Power), and TXU Energy.

Comments on §25.508

Sierra Club, William Leek, Public Citizen, TCU, MidAmerican Energy Group, OPUC, Pro-Star, the City of Houston, Oncor Cities, TIEC, STEC, and TEAM opposed the increase in the SWOC to $4,500/megawatt-hour (MWh). These commenters generally opposed the increase on the grounds that increasing the SWOC would increase electric prices for consumers even though resource adequacy improvements are not guaranteed by such offer cap increases. Sierra Club, Public Citizen, and the Oncor Cities noted changes to ERCOT protocols have already been implemented to address resource adequacy by mitigating price reversal during peak intervals, and cited the need to evaluate first whether these changes are sufficient to increase revenues for generators. TEAM noted that the market response to the actions already taken at ERCOT reduce the need to increase the SWOC for the summer of 2012. To this point, Oncor Cities further cautioned if the additional measure of increasing the SWOC is added to this list of measures to attract new investments by increasing generator revenues, an overcorrection could occur with added costs to consumers. Sierra Club and Public Citizen noted ERCOT's back-casted data analysis showed consumer price increases if SWOC were to be implemented. Finally, Sierra Club, Public Citizen, ConEd, and OPUC, argued that resource adequacy can be addressed by other measures such as increased energy efficiency and demand response, loads bidding into Security Constrained Economic Dispatch (SCED), distributed renewable generation, requiring 500 megawatts (MW) of non-wind renewable generation, improved building energy codes, and new services such as Emergency Response Services (ERS). TCU requested that the commission postpone or completely reconsider the increase in the price cap until a study is completed on the impact of the increase on consumers and the Texas economy, and then compare that impact against the known and measurable benefits the increase will bring. TCU also requested that the increased price caps be compared to other alternatives that would create the incentives for the development of new electricity generation in Texas.

Pro-Star expressed the belief that the lack of new generation build is reflective of current economic conditions and the low price of natural gas instead of any inherent pricing flaw in the ERCOT market design. Pro-Star noted that the proposed increase in the SWOC apparently incented at least 1,200 MWs of mothballed generation to return to the market. To this claim, STEC argued that the rule is not needed for this purpose, as ERCOT already has the power to secure such contracts without the proposed increase in the SWOC. Pro-Star expressed concern over whether increasing the SWOC to $4,500 would have the long-term effect of ensuring resource adequacy.

Senator Davis, Representative Turner, Sierra Club, Mr. Leek, MidAmercian, City of Houston, Oncor Cities, STEC, and TEAM generally expressed concern that raising the SWOC will not lead to greater investments in new generation, while Senator Ellis wanted to ensure that increasing the SWOC would achieve this goal. STEC further commented the SWOC increase to

$4,500 will not accomplish its stated purpose of ensuring resource adequacy or incenting loads to voluntarily reduce their demand, because August 1 would be too soon for new generation to be constructed or loads to significantly change their load reduction behavior during times of scarcity.

City of Houston voiced opposition to the proposed SWOC increase to $4,500/MWh on August 1, 2012 by claiming the commission's adoption of the proposed rule would not withstand judicial scrutiny. City of Houston stated that there is no evidence that increasing the SWOC to $4,500 will provide any benefits in regard to resource adequacy, will have an impact on future wholesale electricity prices, or will result in new generation or demand response. Furthermore, City of Houston commented the proposed rule offers no rationale in terms of implementing the $4,500 amount versus any other dollar amount increase. On these same topics, Senator Ellis and Representative Raphael Anchia, posed the question to the commission of whether or not any analysis has been conducted to determine if raising the SWOC to $4,500 would guarantee new investment in generation. Additionally, Senator Ellis and Representative Turner were concerned that there were no studies on the effect of increasing the SWOC on electricity rates for consumers. Representative Anchia also asked what methodology was implemented to derive the $4,500 amount and whether or not an analysis of cheaper alternative sources such as those noted above, namely, demand response, solar power, storage, or energy efficiency could be implemented versus raising the SWOC.

The City of Houston also noted the proposed rule was published before the release of the Brattle Group report. Their comments expressed the belief that stakeholders should have been provided time to review the implications of the Brattle Report before commenting on this rulemaking. At the very least, City of Houston stated increasing the SWOC should be based on a more coordinated approach under Project No. 40268, *PUC Rulemaking to Amend PUC SUBST. R. §25.505, Relating to Resource Adequacy in the Electric Reliability Council of Texas Power Region*.

TCPA, CPS, Odessa-Ector, Competitive Power Suppliers, NRG, Luminant and TXU Energy expressed support for the increase in the SWOC to $4,500 on August 1, of 2012. TCPA, Odessa-Ector, NRG, Luminant, and TXU stated that the short-term actions will demonstrate a commitment by the commission to ensure resource adequacy, and that this commitment will send a consistent and important message to investors. TCPA also recommended increasing the SWOC this August because scarcity situations also occur in the fall and spring, and increasing the SWOC this summer will ensure that increased scarcity pricing signals will be in place if a scarcity situation occurs. Odessa-Ector noted that the forward markets responded positively to changes brought about by commission action that positively affect both the near term and the long term forward energy markets, and that investors need a strong forward market to allow them to manage the risk of building new generation. CPS noted the current SWOC of $3,000/MWh does not provide the economic incentives required to ensure resource adequacy. CTPS indicated that on-peak prices have been too low to incent new investment and that increasing the SWOC this summer will send the appropriate market signal and provide regulatory clarity and will also motivate existing generation owners to contemplate expansion at existing facilities. CTPS indicated that increasing the SWOC to $4,500/MWh strikes the appropriate balance between price signals to stimulate new investment and potential market risks to generators and retailers.

NRG and Luminant noted that the competitive market responds best when market reforms are implemented, and that simply signaling future SWOC increases does not have the same positive impact on the market as actual implementation. Odessa-Ector noted that increasing the peaker net margin (in conjunction with increasing the SWOC) would provide further support for the forward markets and hence, more investments in new generation.

CPS did acknowledge, however, the increase from $3,000/MWh to $4,500/MWh of the SWOC did have a possible drawback. CPS pointed out that if a generator cannot meet its obligation to provide power, it will be very costly to purchase energy from the market during a high-priced interval. CPS cited the February 2, 2011 event when generators suffered losses due to such needed last minute procurements. CPS noted if the SWOC was $4,500/MWh, such generator losses would be much more exacerbated. NRG acknowledged that increasing the SWOC will have an impact on hedging and collateral requirements. NRG believed that adequate market tools are available for market participants to manage the increase in real-time pricing, and that proposed NPRR 459 would allow ERCOT to address collateral issues in the short term before longer-term solutions can be developed.

Commission Response

The commission agrees with TCPA, CPS, Odessa-Ector, Competitive Power Suppliers NRG, Luminant and TXU Energy that the high SWOC should be increased to $4,500/MWh and MW per hour starting August 1, 2012, as provided for in the proposed rule. ERCOT's reserve margin has declined in recent years. In addition, ERCOT projections indicate that there is a substantial risk that the reserve margin will decline

below ERCOT's target reserve margin of 13.75% absent additional generation investment or significant development of demand response. The commission is committed to ensuring that there is enough energy to meet the needs of Texans this summer and in the years to come. Therefore, the commission seeks to provide the proper price signals in the energy-only ERCOT market to incent the construction of new generation; to incent greater market participation by loads as load resources and through load reductions in response to price signals; and to help ensure that existing generation will remain available. Concerning the latter goal, a higher SWOC will make it less likely that older plants will see an insufficient opportunity to recover costs related to capital needs, operating expense, and an opportunity to earn a sufficient return and therefore shut down. Increasing the high SWOC will help achieve this goal by increasing the amount that resources may bid for energy and other ancillary services, which in turn may affect the market price in both ERCOT administered and bilateral markets.

The commission agrees with Oncor Cities, Austin Energy, Sierra Club and Public Citizen that a great deal of work has gone into implementing measures to mitigate price reversal during peak intervals and to incent energy efficiency, demand response, distributed renewable generation and emergency response service. The commission is currently evaluating changes to its energy efficiency rule in Project Number 39764, and is seeking to coordinate the demand response programs under that rule with demand response programs operated by ERCOT. The commission also adopted earlier this year in Project Number 39948 enhancements to ERCOT's emergency response service program, which allows ERCOT to deploy demand response from contracted loads in emergency situations.

The commission also recently adopted rule amendments to further encourage the development of distributed generation, which were adopted in Project Number 39797 at the May 18, 2012 Open Meeting. Finally, the commission authorized ERCOT to conduct pilot projects, through a rule amendment adopted in Project No. 40150 at the May 18, 2012 Open Meeting. ERCOT has already adopted a pilot project under this authority through which it will procure up to 150 MW of a new type of emergency response service beginning July 15 of this year. The commission views all these past and current projects as complementary to this rulemaking, and not as a substitute to this rulemaking.

The commission concludes that it must act quickly and decisively to address resource adequacy issues. Generation investment decisions require a lead time of several years before generation facilities can be built. While the commission believes that energy efficiency, demand response, distributed renewable generation, and emergency response service will play important roles in addressing resource adequacy, the commission does not believe that these measures are sufficient to ensure adequate electricity in ERCOT.

The commission has relied on, and will continue to rely on, the peaker net margin as an indication of whether the ERCOT market provides sufficient incentives to maintain existing generation and for construction of new generation. Sufficient levels of revenue, as indicated by the peaker net margin, provide the appropriate investment signals to generators. The back-cast evaluation provided by ERCOT shows that the previous protocol changes, along with increasing the high SWOC to $4,500/MWh, would have almost doubled the adjusted 2011 peaker net margin for the evaluated scenarios, indicating

a much more favorable investment environment in ERCOT for generation, while increasing the per MWH load weighted price only approximately 25%. The commission notes that ERCOT's back-cast is based upon 2011 prices and weather. 2011 weather was extreme, with an unusually high number of scarcity pricing intervals caused by extreme cold and heat. These increases strike an appropriate balance between providing sufficient revenues to encourage generation investment while limiting the resulting price impacts on customers in the near term.

While the commission cannot guarantee the construction of new generation, a $4,500 SWOC will make ERCOT a more attractive market to maintain existing generation facilities and encourage future generation investment. The commission disagrees with Pro-Star that the lack of new generation is a reflection only of current market conditions. According to the Independent Market Monitor, since 2007, the peaker net margin reached levels sufficient to support new generation investment only in 2008 and 2011. The peaker net margin in 2008 was due to inefficient transmission congestion management, the potential for which has since been eliminated due to ERCOT's switch to a nodal market. The Independent Market Monitor identified the sufficient price level to support new peaker units as $80-$105 per kilowatt-year in past "State of the Market" reports, and this level was reached in the ERCOT back-cast analysis. Increasing the peaker net margin by increasing the SWOC will provide greater incentives to maintain current generation and to encourage the construction of new generation. While the back-cast evaluation of 2011 is reflective of an extremely hot year and a typical "hot" Texas summer will not produce as high of a peaker net margin, even ERCOT's "weather normalized" back-cast analysis

excluding the extraordinary cold snap in February 2011 showed a substantial increase in the peaker net margin. That analysis suggested a net margin just sufficient to support construction of new peaker units, but insufficient to support other types of needed generation. On the other hand, the new high SWOC will likely indirectly result in higher prices to retail customers and, as discussed below, challenges for some Load Serving Entities (LSEs). The commission believes that the increase in the high SWOC resulting from this rule is an appropriate and important step to maintain resource adequacy while keeping the short-term adverse effects on LSEs and retail customers at a reasonable level.

While the commission agrees with STEC that ERCOT can contract with mothballed units to provide energy, that approach would provide only a temporary solution to a long-term issue. The commission disagrees with the City of Houston that the commission should have waited until the Brattle Report was released before proposing an increase to the high SWOC. This rulemaking is targeted at a specific action, raising the high SWOC, and the back-cast analysis provides sufficient basis to go forward with this action now. The commission also disagrees with the characterization that this rule is not being sufficiently coordinated with Project Number 40268. The commission approved the proposals of the two projects at the same Open Meeting, and increases in the high SWOC for future years will be addressed in Project Number 40268.

Appropriate Timing of SWOC

ConEd, Austin Energy, Mid-American, OPUC, City of Houston, TIEC, Ambit and Stream, Oncor Cities, Texas Power and TEAM do not support the timing of the proposed increase in the

SWOC. These entities generally pointed out that market participants would not have sufficient time to respond to any impacts caused by increasing the SWOC. Sierra Club, Texas Power, ConEd, MidAmerican, OPUC, City of Houston, TIEC, Ambit and Stream, Oncor Cities, Austin Energy, and TEAM do not necessarily oppose an increase in the SWOC, but recommended that implementation be delayed to see if the previous protocol corrections are sufficient or to give market participants time to adjust to the market changes or to reduce the impact on existing contracts.

OPUC and Oncor Cities commented that implementing the change in the SWOC on August 1, 2012 is neither necessary nor warranted because of the availability of sufficient resource capacity for this summer, caused in part by the return of 2000 MW from mothballed status. Among other reasons offered by OPUC for its position were the assumption in ERCOT's resource assessment that the weather in 2012 summer would be less extreme than the 2011 summer; the need to allow the protocol changes and other-reliability-driven administrative initiatives implemented in late 2011 and early 2012 to "play out" this summer; the potential that recent commission action relating to emergency response service, energy storage, distributed generation, ERCOT pilot projects and energy efficiency rules could address the near-term resource adequacy concerns; the concern that market participants have insufficient time to adjust their risk strategies; and potential that Load Serving Entities (LSEs)/Retail Electric Providers (REPs) could interpret the rule change as a "change in law" and therefore break fixed-power contracts and pass the increased costs along to end-users. Oncor Cities commented that increasing the SWOC by August 1 will not incentivize the construction of generation this summer and that an increase in the SWOC this summer presents only the risk of higher prices this year, with no corresponding benefits. MidAmerican believed that addressing the long-term changes to the SWOC though a longer and more deliberate stakeholder process, with the advantage of incorporating the findings from the Brattle Group study would result in a more compelling signal to the market than a rushed rulemaking to raise the SWOC by August 1, 2012 as the appropriate long-term level for SWOC should involve a thorough quantitative analysis.

Austin Energy expressed concern that implementing the increase in SWOC in August would not only expose LSEs to increased price volatility and potential for default which would affect all ERCOT participants, but also adequately hedged LSEs whom may find themselves undercapitalized to meet the credit requirements necessary to transact in the ERCOT market. MidAmerican Energy Company and Ambit and Stream expressed similar concerns. TIEC claimed that the failure to provide the market with sufficient opportunity to adjust to the proposed increase in SWOC by August 1, 2012 will (1) increase financial risk for all markets without providing sufficient time to manage the risks; (2) create uncertainty about pricing under current retail contracts, and 3) increase the risk of REP defaults, which could cause significant market uplifts and Provider of Last Resort (POLR) transitions during the volatile summer months. TEAM explained that the months of July and August are most commonly traded together as a summer block for hedging purposes and increasing the SWOC in the middle of a hedge would, therefore, disrupt hedging products and expose REPs and their customers to risk that would have otherwise been avoided. TEAM supports the implementation of gradual market adjustments that will generate sufficient price signals to incentivize the new generation needed by the growing ERCOT market while allowing market participants to plan and adjust their financial strategies accordingly.

TCPA, Odessa-Ector, CTPS, NRG, Luminant and TXU Energy, on the other hand, strongly supported the implementation of the higher SWOC on August 1, 2012. These entities argued that faster commission action will begin to align market outcomes with investor expectations given that it takes two to three years for most generation technologies to be built.

NRG, TCPA, Luminant and TXU Energy supported the proposal to increase the SWOC beginning August 1, 2012, arguing the market needs this early and strong signal to maintain incentives for current supply and encourage investment in generation and other resources going forward. CPS energy deferred to other market participants on the best time to implement a higher SWOC, from a contracting perspective but supported implementing the higher SWOC as quickly as practical. Luminant, NRG, and TIEC all pointed out that the timing for the end date of §25.508 must be modified in accordance with Commissioner Anderson's memo to clarify that the SWOC change in §25.508 would be in effect only until any amendment to the SWOC was implemented in Project No. 40268, versus the proposed rule language stating the $4,500 SWOC would be effective until May 31, 2013.

Commission Response

The commission has historically demonstrated a commitment to regulatory certainty and extended notice for changes in policy, especially ones that would significantly increase costs, and would not take action on short notice unless there is a compelling reason to do so. The commission is also committed to resource adequacy and has made changes when necessary to support resource adequacy. While the commission appreciates the comments

of ConEd, Austin Energy, Mid-American, OPUC, City of Houston, Ambit and Stream, Oncor Cities, Texas Power and TEAM, who would prefer not to have the high SWOC increase on August 1, 2012, the commission concludes that the timing of the increase is necessary to ensure resource adequacy. As explained above, raising the high SWOC at this time is necessary not only to address the currently insufficient profit opportunities for the construction of new generation. It is also necessary to encourage at this time, in light of the declining reserve margin, greater market participation by loads as load resources and through load reductions in response to price signals, and to help ensure that existing generation will remain available.

The commission does not believe that the announcements that nearly 2,000 MW of mothballed units will return to service this summer eliminates the need for this rule. These announcements were made after this rule was proposed and after the commission extensively discussed increasing the high SWOC, and the commission believes that these signals to the market contributed to these units returning to service. If the commission did not adopt the rule's increase in the high SWOC, the owners of these units and other units would have less incentive to expend money to ensure that their units are available for use and less incentive to participate in the market if their units are available for use. In addition, there would be less incentive for demand-side participation in the market. The commission agrees with NRG, TCPA, Luminant, and TXU Energy that increasing the high SWOC provides a strong signal to the market to maintain incentives for current supply and encourage investment in generation and other resources going forward.

Although the increase in the high SWOC effective August 1, 2012 may increase credit requirements for LSEs and may make hedging more challenging, these potential downsides of implementing the increased high SWOC effective August 1, 2012 are outweighed by the benefits of doing so. LSEs should have sufficient access to capital to address any increased credit requirements and should have sufficient expertise to manage any hedging challenges. In 2009, the commission adopted a new §25.107 that substantially increased the financial requirements for REPs and required that they have expertise in energy commodity risk management.

The commission agrees with the comments from TIEC, NRG, and Luminant that the high SWOC set by this rule should end on the effective date of any amendment to the high SWOC in §25.505 that is effective after the effective date of this rule. The end date for the high SWOC established by this rule should coincide with any change to the high SWOC in §25.505, rather than be set at a fixed date. In Project Number 40268, the commission has proposed to change the high SWOC in §25.505 effective June 1, 2013. However, in adopting a change to the high SWOC in that project, the commission may change that date.

The commission posed one question for comment.

Question: The direct effect of the new section will be to allow resources to offer services in the ERCOT ancillary service auctions at higher prices. In turn, this direct effect is expected to increase revenue to resources, which will be paid for by LSEs including retail electric providers. Will the new section implicate the provisions of §25.475 that allow retail electric providers (REPs) to change rates in fixed-rate products for retail customers due to "changes resulting *from federal, state or local laws that impose new or modified fees or costs on a REP that are beyond the REP's control?"*

Public Citizen, Sierra Club and Oncor Cities stated that the lack of a clear answer to this question is one reason this rule should not be adopted. Oncor Cities highlighted the policy dilemma surrounding this issue and stated the commission is faced with the question of which is the preferable alternative this summer: a) permitting REPs to push a price increase down to their customers, even customers on fixed price contracts, or b) allowing many REPs to suffer the detriment of suddenly higher wholesale prices, including the possibility that some REPs may default as a result. Oncor Cities submitted that neither alternative is an acceptable outcome. Oncor Cities stated that whatever answers the commission arrives at, whether REPs are permitted to pass increased wholesale costs to their fixed-price customers or not, suggests that there are sound reasons for not taking any action in this project at all. City of Houston, Oncor Cities, and IPR-GDF SUEZ did not believe that this rule constitutes a "change in law" as contemplated in §25.475. Direct Energy states that the facts surrounding this project does not merit application of §25.475. IPR-GDF SUEZ, Oncor Cities and OPUC noted that §25.475 applies specifically to changes in federal, state, or local law and that a change to an administrative agency rule is not a federal, state or local law.

IPR-GDF SUEZ, Pro-Star and OPUC argued that the change does not impose a new cost or fee, nor does it modify any existing fee assessed neither by any governmental body nor by any transmission or distribution provider (TDSP). Direct Energy stated that the potential for changes to the SWOC has existed since at least 2005 when the commission discussed the appropriate scarcity pricing mechanism and eliminated the "shame" cap. IPR-GDF SUEZ stated that it is difficult to argue that the SWOC should be considered a "cost" as the SWOC is not itself a cost; it is a cap on the price at which power may be offered. Although raising the SWOC permits generators to charge a higher amount for power than under the previous rule, it does not necessarily impose a higher cost on REPs. OPUC argued that under the rules, when a REP ends up paying high spot market prices, those higher prices cannot be passed through to the fixed rate products and if the SWOC is increased, the only change that would occur is the degree to which the spot prices would increase, therefore under the current version of §25.475, the additional costs to REPs for the energy cannot be passed through.

OPUC, Direct Energy, Cities and Pro-Star opined that any increased cost is not "beyond the REPs control." Direct Energy stated that the negative impacts, if any, on longer term fixed price contracts are avoidable in a market where hedging all or a portion of sales is essential to prudent risk taking and practice. Pro-Star stated that the majority of any cost increases incurred by the REP are the result of business decisions made by the REP and not an increase in the SWOC. Pro-Star offered a methodology for measuring the potential impact of the increased SWOC on such ancillary services. Pro-Star stated if the SWOC increase is implemented, only the amounts derived from their calculation methodology should be allowed to be passed on to customers.

OPUC also expressed concern that if the REPs are allowed to breach the customer fixed price contracts then customers will be forced to pay a higher price for the future and will also have lost money spent in the past for security they did not receive. If REPs do change the price to fixed price customers, OPUC would encourage REPs to provide those fixed price customers with 14 days' notice that their price will increase and allow those customers to switch providers without incurring termination penalties.

TIEC, Luminant, NRG, TXU and TEAM believed that increased costs should be allowed to be passed through to residential and small commercial customers on fixed price contracts. TIEC stated that the direct effect of this rule will be to increase the SWOC by 50% for both energy and ancillary service costs creating additional costs that were not considered when LSE's negotiated their current supply arrangements and would appear to implicate the change in law provisions. NRG stated that the commission's proposed rule creates the potential for increased costs to hedge and protect against 4,500/MWh prices or pay wholesale energy costs as high as $4,500/MWh.

NRG noted that the Texas Government Code §2001.003(6)(A) describes a Rule to mean "a state agency statement of general applicability that interprets or prescribes law or policy or describes the procedure or practice requirements of a state agency." TXU and Luminant agreed that the commission could reasonably interpret §25.475 to allow REPs to increase the price of existing fixed-rate contracts to the extent that REPs' actual costs increase due to an increase in the cost of wholesale power caused by the change in SWOC. Luminant and TXU stated that if the commission does allow these charges to be passed through on fixed price charges that the commission should indicate in its order approving this rule that REPs should be prepared to explain that any such increases are solely attributable to the increase in the SWOC. TEAM stated that the commission's rules, made with its direct and implied powers designated by the Legislature have the same power and effect as laws for the purposes of reliance by and enforcement on market participants. Therefore, TEAM argued, a change in the commission's rules raising the SWOC would be a change in law that could impose modified costs on a REP.

TEAM stated that the more difficult question is whether or not the increased costs are beyond the REP's control. TEAM stated that this is a fact question that must be resolved individually for each REP. Some REPs may have resources that allow them to adjust and control increased costs on a near-term basis through hedging or other market strategies while others may have undertaken different hedging strategies that were priced according to rules and associated market risk that applied at the time the contracts were entered into and therefore it would not be appropriate to determine the answer to this question as a "yes" or "no." Ambit and Stream indicated that there is an inadequate understanding of how retailers will measure, plan, and pass through to term customers the incremental costs related to changes in the SWOC and Power Balance Penalty Curve (PBPC).

While TXU agreed that changing the prices is permissible under the rule, it stated that changing the price of a fixed price contract would likely create a negative customer experience and would generally be inconsistent with TXU's business practices and its expectation and desire is to leave the residential and small-commercial fixed-rate contracts as-is.

Commission Response

While the commission was interested in viewpoints on whether an increase in the high SWOC implicates the referenced provisions in §25.475, the issue was not addressed in the proposed rule. The commission will carefully evaluate the issue in a contested case if a

REP seeks to raise its prices to customers on the basis of the cited provisions and a formal complaint is brought by a customer or an enforcement action is brought by the commission's executive director. The commission concludes that this rule is necessary to address resource adequacy, and should therefore be adopted regardless of whether the rule implicates the cited provisions.

Power Balance Penalty Curve

Competitive Power Suppliers and the individual comments from NRG also suggested the power balance penalty curve (PBPC) should be increased along with the SWOC increase. Specifically, NRG suggested the PBPC should start at $500 and increase to the SWOC of $4,500 versus starting at the current $200 for a 1 MW power balance violation and increasing nonlinearly to the current SWOC of $3000. NRG suggested the PBPC should start at $500 and then move to the SWOC of $4,500 so as not to interfere with competitive bids. Alternatively, TIEC suggested the slope of the PBPC should be lessened to allow various loads and generation to respond at certain points in reaching the peak of the PBPC. TIEC noted a PBPC that is too steep will result in the more expensive units being chosen by SCED.

Commission Response

The commission appreciates the comments of Competitive Power Suppliers, NRG and TIEC on the Power Balance Penalty Curve. However, the commission is not setting the level of the Power Balance Penalty Curve in this rule.

All comments, including any not specifically referenced herein, were fully considered by the commission. In adopting this section, the commission makes modifications for the purpose of clarifying its intent.

This new section is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (West 2007 and Supp. 2011) (PURA), which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically §35.004, which requires that the commission 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 §39.001, which establishes the Legislative policy to protect the public interest during the transition to and in the establishment of a fully competitive electric power industry; §39.101, which establishes that customers are entitled to safe, reliable, and reasonably priced electricity, and gives the commission the authority to adopt and enforce rules to carry out these provisions; and §39.151, which grants the commission oversight and review authority over independent organizations such as ERCOT.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 35.004, 39.001 39.101, and 39.151.

§25.508. High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region.

Notwithstanding §25.505 of this title (relating to Resource Adequacy in the Electric Reliability Council of Texas Power Region), the high system-wide offer cap shall be $4,500 per megawatt-hour and $4,500 per megawatt per hour beginning on August 1, 2012 and ending on the effective date of any amendment to the high system-wide offer cap in §25.505 of this title that is effective after the effective date of this section.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §25.508, relating to High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region, is hereby adopted with changes to the text as proposed.

SIGNED AT AUSTIN, TEXAS on the ______ day of JUNE 2012.

PUBLIC UTILITY COMMISSION OF TEXAS

____

DONNA L. NELSON, CHAIRMAN

____

ROLANDO PABLOS, COMMISSIONER

Q:\CADM\TXR-Rules Management\Rules\Rulemaking Projects\Electric\37xxx\37897\37897 adt.docx