TESTIMONY BY THE TEXAS COALITION FOR AFFORDABLE POWER
FOR THE
SENATE COMMITTEE ON BUSINESS & COMMERCE

JANUARY 10, 2011

The Texas Coalition for Affordable Power ("TCAP") is a coalition of 163 political subdivisions — mostly cities — that purchase electricity in the deregulated market. The largest coalition of its type in the state, TCAP procures 1.4 billion kilowatt/hours annually for over 16,000 retail electric accounts. TCAP appreciates Chairman Carona and the committee for providing this opportunity to address issues pertaining to the reliability of the electric grid. A reliable supply of electricity is critical to political subdivisions' ability to protect the health and safety of its citizens.

Last summer Texas endured one of the hottest summers in its history. We have to go all the way back to 1789, searching through the tree ring records, to find evidence of a more difficult drought. Electric generation plants depend upon a reliable supply of water and when lake levels drop — as they often do when there's high heat and no rain —plants can shut down. ERCOT reports that Texas could lose between 434 and 3,000 megawatts of generation by May, depending upon future rainfall.

This is a serious situation, and one that should not be taken lightly. But we also urge you to keep the events of last summer in perspective. Remember that while the drought is ongoing, the extent of the heat itself may have been an anomaly. Records were broken across the state in July and August, which increased demands on the grid and lowered reserve margins. We can only hope that next summer won't be as difficult. Although we can never know what the future holds, if the heat is even slightly less severe, we may see a lessoning of the burden on the grid.

It is important for policymakers to avoid potentially onerous decisions based upon what was, quite literally, a once-in-a-200-year situation. What is required, then, is additional information — and a measured response. For instance we support ERCOT's pursuit of more rigorous reporting and scheduling requirements for generators. We also believe that penalties should be enhanced for rules violations by generators — including those that threaten grid reliability. We likewise appreciate some of the responses we've seen so far from the generation community, including their efforts to procure additional water rights and their efforts to add pumping capability.

But the pursuit of other over-arching policy changes — especially those that do not excessively punish ratepayers — may be difficult. Because Texas operates a deregulated market, many of the levers that otherwise would allow policymakers to directly address reliability issues are no longer available. Neither does our nodal system help. The original policy considerations that supported its creation included the claim that the ability to allocate costs to specific nodes would lead to the addition of generation where prices were high. But we now understand that non-attainment zones to protect air quality and the location or quantity of limited water resources and fuel sources will frustrate, if not preclude, that alleged benefit. Instead, the nodal system may consistently lead to

high wholesale prices in certain areas of the state where the drought has made new generation construction impractical. And, of course, no amount of new investment or policy refinements will make it rain.

We ask that you keep these points in mind as you continue this policy debate. Many within the generation community have pointed to the extreme weather of last summer to support changes that would both increase wholesale electricity prices and violate competitive principles. These proposals would — by their very design — make retail electricity more expensive. Generation companies say they need to have larger profit margins so they'll have the economic incentive to build more power plants. But they offer no guarantees. And without additional water resources, it may be impossible to add new traditional generation in certain areas, regardless of the profit margins of generators. All we have is the *hope* that by throwing money at generation companies — money that ultimately comes from the pockets of your constituents — that generation companies will somehow make our reliability challenges go away.

One particularly troubling proposal would create artificial price supports for a portion of the state's wholesale energy market. That is, in certain instances generators would face a regulatory *prohibition* against offering low-priced wholesale energy. The support from the generation community for this proposal is ironic, given that many now supporting this bit of regulatory intervention also are on record complaining about burdensome regulations and the need to allow the free market to operate.

In other proposals — proposals that go to the other extreme — regulators would raise or eliminate existing offer caps for wholesale energy. Like other states, Texas currently enforces these caps to ensure the market does not go haywire. These caps are not meant to stifle competition, but rather to ensure that prices do not shoot beyond what we would expect in a healthy competitive market. If Texas adopts higher regulatory caps, you can bet your bottom dollar that it won't be long before the wholesale spot market hits them. This will lead to higher electricity prices at home. The situation could be much worse for consumers if there's no cap at all.

That's why we're advocating for a measured response, and one in which policymakers use the tools at hand. We urge caution and careful deliberation, continued review, and useful protocol adjustments. At the same time we would discourage policymakers from pursuing changes that punish cities, businesses, residential consumers and other purchasers of electricity — but with no clear pay-off in terms of reliability.

We have a few suggestions:

1) Along with water rights for municipal and residential use, water for electric generation should continue to be given the highest priority in times of critical shortage.

2) Rather than incentivizing construction of new generation facilities that require water resources that may not be available, we should investigate ways to encourage the development of solar power in West Texas without driving current retail rates higher. The

goal should be to maximize the efficiency and usefulness of the new CREZ transmission system by matching wind power (which is most productive in evenings and off-peak hours) with energy generated during peak hours by the sun — that is, from the same source that is bringing us hot summers.

3) Consider building codes for new construction that mandate the use of best available technology for conserving both electricity and water.

4) Carefully monitor pricing under the nodal system to ensure that areas of the states are not punished with disproportionately higher electric rates when the addition of generation units in those areas is precluded because of limited natural resources or mandated constraints.

5) Carefully monitor PUC and ERCOT policies to ensure that principles of competitive markets are not compromised by artificial pricing to enhance profits for incumbent providers.

TCAP would like to thank ERCOT and the PUC for their efforts so far, and thank the Committee for its careful consideration of this important issue.

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