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PROJECT NO. 47199

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PROJECT TO ASSESS PRICE-  
FORMATION RULES IN ERCOT'S  
ENERGY-ONLY MARKET

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**VISTRA ENERGY'S REPLY COMMENTS**

Vistra Energy Corp. (Vistra Energy) submits the following replies to the initial comments in response to the request issued by the Public Utility Commission of Texas (Commission) on October 27, 2017.<sup>1</sup>

**I. INTRODUCTION**

Vistra Energy appreciates the opportunity to submit these reply comments regarding the NRG/Calpine-commissioned whitepaper by Drs. Hogan and Pope (NRG/Calpine Whitepaper). Having reviewed the initial comments, Vistra Energy continues to: (1) oppose marginal loss pricing as a fundamental shift in the way that transmission losses have been priced in ERCOT for nearly two decades, to the significant detriment of most generators, other market participants, and communities throughout the state; (2) support our price adder to ensure that system-wide prices appropriately reflect the value of all generation that is needed to serve load; (3) oppose the implementation of a locational reserve requirement or local Operating Reserve Demand Curve (ORDC) as unnecessary; and (4) support improvements to the system-wide ORDC.

**II. REPLIES**

**A. Marginal Losses**

Marginal loss pricing is fundamentally inconsistent with almost twenty years of Texas policy and would change the rules in the middle of the game for both generators and retail customers. It would also be a significant design change to a market that is working reasonably well and would be substantially detrimental to the majority of the market, while benefiting only a few. Of the twenty-three stakeholders

<sup>1</sup> Public Utility Commission of Texas Request for Comment (Oct. 27, 2017). All citations are to filings made in Project No. 47199, unless otherwise noted.

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that filed initial comments, only three (aside from NRG and Calpine) supported marginal losses,<sup>2</sup> and of those, one conditioned its support on “proper” implementation, meaning the use of multiple reference buses to calculate losses,<sup>3</sup> which is not practically workable. The remaining commenters either did not comment or take a position on the issue,<sup>4</sup> proposed further study,<sup>5</sup> or actively opposed the proposal.<sup>6</sup> Vistra Energy agrees with the numerous commenters that oppose marginal loss pricing as a significantly detrimental proposal for ERCOT.

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<sup>2</sup> See Comments of Golden Spread Electric Cooperative, Inc. at 1 (Dec. 1, 2017) (hereafter, Golden Spread’s Comments) (contending that marginal losses are a design improvement “that will improve market efficiency and transparency and ultimately lead to more efficient long-term investments that contribute to improved reliability”); Shell Energy’s Comments at 3 (Dec. 1, 2017) (contending that “the lack of a marginal loss component in pricing suppresses price signals that would encourage the location of resources closer to load, which would improve regional reliability and reduce losses”); South Texas Electric Cooperative, Inc.’s Response to the Commission’s October 27, 2017 Request for Comments at 3 (Dec. 1, 2017) (hereafter, STEC’s Comments) (supporting a “properly instituted” marginal loss mechanism).

<sup>3</sup> STEC’s Comments at 13 (Dec. 1, 2017).

<sup>4</sup> Comments of Dynegy Inc. (Dec. 1, 2017) (hereafter, Dynegy’s Comments); Comments of Exelon Corporation (Dec. 1, 2017) (hereafter, Exelon’s Comments); Comments of Rainbow Energy Marketing Corporation (Dec. 1, 2017) (hereafter, REMC’s Comments); Comments Submitted by Tenaska (Dec. 4, 2017) (hereafter, Tenaska’s Comments); Comments of the Texas Advanced Energy Business Alliance (Dec. 1, 2017) (hereafter, TAEBA’s Comments) (though not taking a position on marginal losses, did note that the allocation of excess revenues would be “highly controversial”); Texas Competitive Power Advocate’s Response to the Request for Comments (Dec. 1, 2017) (hereafter, TCPA’s Comments); TEAM Comments in Response to Staff Questions (Dec. 1, 2017) (hereafter, TEAM’s Comments).

<sup>5</sup> See Comments of Direct Energy, LP at 2 (Dec. 1, 2017) (hereafter, Direct’s Comments) (suggesting that marginal losses merit further consideration, but that a “comprehensive cost/benefit analysis” should be completed prior to any decision on whether to implement); Lower Colorado River Authority’s Comments at (Dec. 1, 2017) (hereafter, LCRA’s Comments) (supports “more in-depth discussions by market participants on this topic” and an “independent evaluation”).

<sup>6</sup> Austin Energy’s Response to Request for Comments at 3 (Dec. 4, 2017) (hereafter, Austin Energy’s Comments) (implementing marginal losses “would reward or penalize generating companies for siting decisions made decades prior to today”); Initial Comments of Environmental Defense Fund of Texas, Inc. in Response to Commission Staff’s Request for Comments at 2 (Dec. 1, 2017) (hereafter, EDF’s Comments) (marginal losses may “undermine the competitive market” by retroactively affecting prior investment decisions and “potentially bail[ing] out resources that would exit the market” otherwise); The ERCOT Steel Mills’ Joint Comments at 10 (Dec. 1, 2017) (hereafter, ERCOT Steel Mills’ Comments) (no compelling case has been made for marginal losses); Comments from Invenergy, LLC at 5 (Dec. 1, 2017) (hereafter, Invenergy’s Comments) (opposes as a “dramatic reversal of core economic policies in the State”); Lone Star Chapter of the Sierra Club’s Comments at 5 (Dec. 1, 2017) (hereafter, Sierra Club’s Comments) (concerned about the “needs and benefits” of marginal losses as it “would be a significant departure from our unique ERCOT model”); Texas Industrial Energy Consumers’ Initial Comments at 3 (Dec. 1, 2017) (hereafter, TIEC’s Comments) (should not adopt marginal losses and cause “significant collateral damage to customers and certain thermal generators”); Comments of Texas Solar Power Association at 1 (Dec. 1, 2017) (hereafter, TSPA’s Comments) (marginal losses would not “directly address the lack of efficient investment and retirement signals” and instead “would simply shift revenue from generators in rural communities, to generators in urban load centers without changing market outcomes”); Comments from the Wind Coalition at 3–4 (Dec. 1, 2017) (hereafter, Wind Coalition’s Comments) (marginal losses would “unwind ... long-standing foundational policies” and “not only penalize existing generators” but also “likely have a chilling effect on new builds”).

Supporters claim two benefits of marginal loss pricing—(1) that it would result in better future siting decisions, and (2) that it would improve market efficiency. These claims are both flawed for the reasons set forth below.

As discussed in Vistra Energy’s initial comments, marginal loss pricing is not likely to have any effect on future siting decisions, but instead, would penalize existing generators based on siting decisions they made years (and sometimes decades) ago. Siting decisions are based on numerous and varied reasons, including the location of a generator’s specific load (as compared to the theoretic and amorphous center of load), the availability of land, access to natural resources, and environmental restrictions. Simply shifting the method of accounting for transmission losses from an average basis to a marginal basis will not change any of those considerations. As urged in the initial comments of a wide variety of stakeholders (including renewable resources, industrial customers, and a municipally-owned utility), adopting marginal losses would:

- “undermine the competitive market by raising the prospect that the Commission will order changes to the current market structure that could retroactively affect prior investment decisions”<sup>7</sup>;
- “caus[e] significant collateral damage to customers and certain thermal generators”<sup>8</sup>;
- “simply shift revenue from generators in rural Texas communities, to generators in urban load centers without changing market outcomes”<sup>9</sup>;
- “penalize existing generators that will face substantial losses in net revenues” and “likely have a chilling effect on new builds”<sup>10</sup>; and
- “create new winners and new losers.”<sup>11</sup>

Further, improving “market efficiency” should not be pursued at all costs. As urged by the ERCOT Steel Mills, “[e]ven if the market can be made more economically efficient, this does not mean

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<sup>7</sup> EDF’s Comments at 2 (Dec. 1, 2017); *see also* ERCOT Steel Mills’ Comments at 10 (Dec. 1, 2017) (marginal losses will “disadvantage market participants whose long-standing business plans have been predicated on continuation of the current treatment of line losses”); Invenenergy’s Comments at 8 (Dec. 1, 2017) (marginal losses would “change a foundational premise upon which judicious actions were taken”).

<sup>8</sup> TIEC’s Comments at 3 (Dec. 1, 2017).

<sup>9</sup> TSPA’s Comments at 1 (Dec. 1, 2017).

<sup>10</sup> Wind Coalition’s Comments at 4 (Dec. 1, 2017).

<sup>11</sup> Austin Energy’s Comments at 7–8 (Dec. 4, 2017).

that doing so is necessarily appropriate or desirable, let alone essential.”<sup>12</sup> A marginal loss basis for pricing transmission would come at significant cost for generators throughout the state in a power market that is already experiencing sustained low power prices, at an estimated \$239 million of annual losses in net revenues.<sup>13</sup> Those losses could drive some generators to make premature retirement decisions, resulting in a loss of salaries and revenue for the relevant communities.<sup>14</sup> Load Serving Entities would also be negatively impacted, as “their long-term supply contracts,” which take into account the current mechanism for pricing transmission losses, would “no longer reflect their underlying cost and risk structures.”<sup>15</sup> In addition, the implementation of marginal losses would cost a minimum of \$10 million, and this estimate is likely understated, given the controversy and costs expected to result from the debate regarding the appropriate allocation of excess revenues if marginal losses are implemented.<sup>16</sup>

Though it is certain to result in substantial costs to the market, the marginal loss mechanism would not significantly improve market efficiency, resulting in only \$8.6 million in annual production cost savings in ERCOT.<sup>17</sup> While NRG commented that the marginal loss pricing mechanism would pay for itself in less than two years (because the estimated \$10 million cost is only slightly more than the projected \$8.6 million annual production cost savings),<sup>18</sup> that comment ignores the substantial cost to the market and communities throughout the state. In other words, the total costs—considering not only the costs for ERCOT to implement marginal loss pricing, but also the significant costs to generators, other market participants, and communities throughout the state—are not worth the comparatively insignificant incremental improvements in market efficiency.

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<sup>12</sup> ERCOT Steel Mills’ Comments at 2 (Dec. 1, 2017).

<sup>13</sup> The Brattle Group’s Analysis of Marginal Losses Proposal (Oct. 12, 2017).

<sup>14</sup> Invenergy’s Comments at 6–8 (Dec. 1, 2017) (noting that Invenergy stands to lose \$9 to \$11 million per year if marginal losses are implemented and that this is “not a market variable with fluctuation that can be built in to project models and planned for”; further noting that it paid over \$34 million in taxes, land payments, and salaries and made over \$76,000 in Good Neighbor Program donations in 2016 alone).

<sup>15</sup> Austin Energy’s Comments at 3 (Dec. 4, 2017).

<sup>16</sup> See TAEBA’s Comments at 9 (Dec. 1, 2017) (“If the Commission decides to adopt marginal loss pricing, then it also must answer the *highly controversial question* of how to handle over-collection. . . . The specifics of how over-collected payments are repaid can have significant effects and spur controversy and litigation. For example, in 2010 in CAISO, two alternative repayment schemes were proposed that would have changed the repayment method by \$18.8 million and 13.8 million, respectively, as compared to the status quo method. In PJM, the allocation of excess marginal loss revenues has spurred costly and long-running litigation.”) (emphasis added).

<sup>17</sup> Analysis of Marginal Losses Proposal (Oct. 12, 2017).

<sup>18</sup> NRG Response to Request for Comment at 14 (Dec. 1, 2017) (hereafter, NRG’s Comments).

Additionally, and perhaps most troublingly, a marginal loss basis for pricing transmission would upend a policy decision made by the Legislature nearly twenty years ago. As explained by a number of initial commenters, the decision to socialize the costs of transmission and thereby to put all wholesale market participants on a level playing field was one that the Legislature made when it directed the move to competition.<sup>19</sup> The fact that marginal losses are the norm in the rest of the country is irrelevant to whether that methodology is appropriate for ERCOT. The rest of the country is subject to the plenary jurisdiction of the Federal Energy Regulatory Commission (FERC), and in that arena, transmission costs are allocated based on a beneficiary pays model.<sup>20</sup> In ERCOT, the decision was made at the outset of the competitive market to socialize transmission costs. Further, the concept of marginal losses was considered, and rejected, when the wholesale market rules were adopted.<sup>21</sup> Changing the rules in the middle of the game for ERCOT generators and loads will unfairly penalize generators and loads that cannot change their siting decisions, will negatively impact communities throughout the state, and will potentially chill future investment in the state by signaling an unstable regulatory environment.

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<sup>19</sup> See, e.g., Austin Energy's Comments at 8 (Dec. 4, 2017) ("All market participants have played by and relied on the same set of rules for nearly two decades; one has to question the fairness of changing those rules and how such a change would assist customers that are benefiting already from historically low prices."); ERCOT Steel Mills' Comments at 10 (Dec. 1, 2017) ("The current policy has been in place for a long time and it has worked well and is consistent with the legislated way transmission costs are allocated. . . . Simple allocation of average losses allows [Locational Marginal Prices] to be the same from one transmission area to another when transmission congestion is not present. This simplification helps even the small players in ERCOT's markets compete on an even playing field with larger more sophisticated companies, and facilitates new market entry."); TIEC's Comments at 13 (Dec. 1, 2017) (contending that marginal losses "are fundamentally incompatible with ERCOT's transmission cost allocation, where the costs of transmission assets are socialized across ERCOT regardless of who benefits from a particular project" and that the "Legislature intentionally socialized transmission costs in this manner to recognize that all ERCOT customers benefit from a robust, integrated transmission grid, and to avoid penalizing customers [in] areas of the state that are chronically transmission-constrained in a manner that could impede economic development"); Wind Coalition's Comments at 3 (Dec. 1, 2017) ("The long-standing market policies of non-discriminatory open access to transmission and postage stamp pricing for transmission service coupled with postage stamp allocation of transmission losses, without penalty as to location, have been in place for more than fifteen years and serve as the framework that have led stakeholders to invest billions of dollars in developing generation assets in ERCOT's energy-only market.").

<sup>20</sup> TIEC's Comments at 13 (Dec. 1, 2017) (citing *Illinois Commerce Commission v. FERC*, 576 F.3d 470, 477 (7th Cir. 2009)); see also TSPA's Comments at 7 (Dec. 1, 2017) ("The fact that other ISOs employ a similar function in their markets is not justification for implementing a marginal loss penalty in ERCOT.... The implementation of a marginal loss penalty for generation owners in rural Texas should be decided based on the merits to Texans; based on the available analysis, any merits are far outweighed by the costs.").

<sup>21</sup> See, e.g., ERCOT Steel Mills' Comments at 10 (Dec. 1, 2017) ("At the time the current market was created, the concept was actively considered but ultimately rejected by stakeholders and the Commission."); Austin Energy's Comments at 4 (Dec. 4, 2017) ("Market participants have debated these concepts for many years and concluded that the benefit of the change was not worth the cost of the change.").

In sum, implementing marginal losses would be a fundamental, unnecessary, and significantly detrimental design change for the ERCOT market, which is currently working reasonably well. Marginal losses also would do nothing to address the market issues that do exist, such as the price distorting impact of federally-subsidized renewable resources and the pricing mechanism's current failure to fully value dispatchable resources when renewable resources are the marginal unit. For all these reasons and those set forth in Vistra Energy's initial comments, the Commission should not adopt marginal losses.

## **B. Vistra's Proposed Adder**

Rather than pursue a fundamental change to the ERCOT market design to the benefit of one group of generators at the expense of the rest of the market (i.e., marginal losses), the Commission and ERCOT stakeholders should give serious consideration to Vistra Energy's proposed price adder to address the current failure of prices to recognize the full costs of traditional dispatchable resources when renewable resources are the marginal unit. Unlike the marginal loss proposal, the price adder would not arbitrarily shift revenues from one group to another, but instead would correct a flaw in the current pricing mechanism, which unfairly fails to properly value dispatchable resources. Dynegy,<sup>22</sup> Exelon,<sup>23</sup> and the Texas Competitive Power Advocates<sup>24</sup> each agreed that ERCOT's pricing mechanism should properly value traditional dispatchable resources.

Vistra Energy disagrees with the Texas Advanced Energy Business Alliance that this price adder would "prop up" prices for thermal generation<sup>25</sup>—rather, the price adder would simply correct for a flaw in the current pricing mechanism that completely ignores the costs of dispatchable resources when those resources are online and operating at their Low Sustained Limit (LSL). Allowing the price to reflect all the generation needed to serve load is not an inflation of or "propping up" of the price; it is the economically appropriate pricing outcome.

In response to Shell Energy's concerns that the price adder would remove incentives for investing in flexible resources,<sup>26</sup> that is not the intent of the proposed adder. Vistra Energy is open to

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<sup>22</sup> Dynegy's Comments at 2 (Dec. 1, 2017).

<sup>23</sup> Exelon's Comments at 7, 34 (Dec. 1, 2017).

<sup>24</sup> TCPA's Comments at 5 (Dec. 1, 2017).

<sup>25</sup> TAEBA's Comments at 8 (Dec. 1, 2017).

<sup>26</sup> Shell Energy's Comments at 6 (Dec. 1, 2017).

evaluating the appropriate incentives for flexible resources as well, but the intent of the instant proposal is to correct the flaw in the current pricing mechanism with respect to dispatchable resources operating at their LSL. As explained in initial comments, the price adder would allow prices to reflect those costs to serve load that today are masked by the ERCOT optimization that treats all zero to LSL energy as price-taking. The Commission should consider pursuing this price adder or something similar.

### **C. Local Reserve Requirement / Local ORDC**

Vistra Energy agrees with ERCOT Steel Mills that a local reserve requirement is an unnecessary “solution” looking for a problem, because ERCOT “has flatly stated” that there is no need for a local reserve requirement.<sup>27</sup> Vistra Energy also agrees with TIEC that a local ORDC would be an “unprincipled” way to address local congestion issues, which would “funnel additional revenue to specific generators located in the Houston area, while harming customers (particularly in Houston) and generators in other areas of the state.”<sup>28</sup>

Rather than creating an unnecessary local reserve requirement or local ORDC that could enable generators in load pockets to take advantage of situational outages, a better solution for persistent congestion is to provide customers in the load pockets with access to the abundant, low-cost generation throughout the ERCOT system through new transmission projects when the costs of those projects would be more than offset by the reduction in congestion costs. As explained by TIEC:

Once congestion costs are sufficiently high, it will be in consumers’ interest to build transmission that will reduce those costs and, in turn, reduce the likelihood of a significant load pocket that might cause reliability issues later. From the perspective of consumers, who pay for all transmission costs in ERCOT, this type of economic planning is a cost-effective [] way to ensure local reliability and limit sustained congestion costs....<sup>29</sup>

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<sup>27</sup> ERCOT Steel Mills’ Comments at 11 (Dec. 1, 2017); *see also* Electric Reliability Council of Texas, Inc.’s Second Report in Response to Commission Staff’s Request at 2 (Sept. 29, 2017).

<sup>28</sup> TIEC’s Comments at 11 (Dec. 1, 2017).

<sup>29</sup> TIEC’s Comments at 10 (Dec. 1, 2017).



The Houston Import Project, scheduled to come online in summer 2018, is anticipated by ERCOT to largely relieve the existing constraints in the Houston area.<sup>30</sup> Likewise, the Valley Import Project is scheduled to come online by the end of 2018 and will similarly relieve congestion in another constrained area of ERCOT.<sup>31</sup> In short, rather than adopt local reserve requirements or a local ORDC, the Commission should re-visit the economic transmission planning test that allows for new transmission to be built when the costs of those projects will be more than offset by the reduction in congestion costs.<sup>32</sup>

#### **D. System-Wide ORDC**

Finally, numerous commenters suggested improvements to the system-wide ORDC,<sup>33</sup> such as deducting the capacity of Reliability Unit Commitment units when calculating available reserves and potentially adjusting other key variables such as the Loss of Load Probability or Value of Lost Load. Vistra Energy agrees with the weight of comments that the Commission should evaluate improvements to the system-wide ORDC. Such an approach would leverage the work the Commission has already done to improve pricing during scarcity conditions, shares broad support among stakeholders, and could consist of tweaks rather than a wholesale overhaul of the market design.

### **III. CONCLUSION**

We appreciate the Commission's thoughtful approach to this Project and its consideration of these comments, and we look forward to engaging with others to discuss our proposals and other potential refinements to the ERCOT wholesale market in the near future.

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<sup>30</sup> ERCOT, Report on Existing Potential Electric System Constraints and Needs at ii (Dec. 2016) (characterizing the Houston Import Project as "the" long-term solution to congestion in Houston).

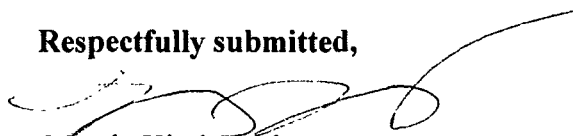
<sup>31</sup> See General Session Minutes of the Board of Directors Meeting of the Electric Reliability Council of Texas, Inc. at 6 (Jun. 14, 2016) (noting that the Board approved the Valley Import project), *available at*: [http://www.ercot.com/content/wcm/key\\_documents\\_lists/76336/June\\_14\\_2016\\_Board\\_General\\_Session\\_Meeting\\_Minutes.pdf](http://www.ercot.com/content/wcm/key_documents_lists/76336/June_14_2016_Board_General_Session_Meeting_Minutes.pdf).

<sup>32</sup> For more discussion of the history of this planning test, see TIEC's Comments at 10 (Dec. 1, 2017).

<sup>33</sup> Calpine Corporation's Comments at 11–12 (Bates) (Dec. 1, 2017); Dynegy's Comments at 3 (Dec. 1, 2017); Exelon's Comments at 4–7 (Dec. 1, 2017); LCRA's Comments at 1 (Dec. 1, 2017); NRG's Comments at 7–8 (Dec. 1, 2017); REMC's Comments at 1 (Dec. 1, 2017); Shell's Comments at 2 (Dec. 1, 2017); Sierra Club's Comments at 4 (Dec. 1, 2017); TCPA's Comments at 2–5 (Dec. 1, 2017); Tenaska's Comments at 1–2 (Dec. 4, 2017); Wind Coalition's Comments at 1, 3 (Dec. 1, 2017).

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