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REVIEW OF THE ERCOT SCARCITY PRICING MECHANISM	§ §	**PUBLIC UTILITY COMMISSION OF TEXAS**

TEXAS PUBLIC POWER ASSOCIATION'S INITIAL COMMENTS REGARDING THE REVIEW OF THE ERCOT SCARCITY PRICING MECHANISM

The Texas Public Power Association (TPPA) appreciates the opportunity to submit these initial comments regarding whether the low system-wide offer cap (LCAP), triggered by exceptionally high real-time market prices experienced during the recent February 2021 extreme winter weather event, should be adjusted prior to this summer.[1] These comments are submitted on behalf of TPPA and do not necessarily reflect the opinions of any individual TPPA member.

Formed in 1978, TPPA is the statewide association for the 72 municipally-owned utilities (MOUs) in Texas. TPPA serves urban, suburban, and rural Texas and member MOUs vary in size from large, vertically-integrated utilities to small distribution systems. We are proud to serve 5.1 million Texans in these cities and towns. Sixty-two of our members are operating within the Electric Reliability Council of Texas (ERCOT) region and ten are located within either the Southwest Power Pool (SPP) or Midcontinent Independent System Operator (MISO) region. MOUs offer a long track record of stability and we serve an essential role in providing secure and reliable power to the wholesale electricity markets in these regions, including ERCOT. Many of our member systems have been providing stable reliable electric power to communities and Texas for over 100 years.

[1] Due to the unique nature of the February 2021 extreme winter weather event, the Commission found good cause to suspend the use of the LCAP due to abnormal gas prices and issued such an order on February 15, 2021 (*Calendar Year 2021 – Open Meeting Agenda Items without an Associated Control Number*, Project 51617, Order Directing ERCOT to Take Action and Granting Exception to Commission Rules (Feb. 16, 2021)). This order was superseded by a second order on February 16, 2021 for reasons unrelated to the LCAP suspension (*Calendar Year 2021 – Open Meeting Agenda Items without an Associated Control Number*, Project 51617, Second Order Directing ERCOT to Take Action and Granting Exception to Commission Rules (Feb. 16, 2021)). The Commission issued an order to reinstate the LCAP on March 3, 2021 after natural gas prices had stabilized, recognizing that the peaker net margin threshold that triggers the LCAP had been reached on February 16, 2021 and good cause no longer existed to suspend the use of the LCAP (*Issues Relating to the State of Disaster for the February 2021 Winter Weather Event*, Project 51812, Order Reinstating Low System-Wide Offer Cap (Mar. 3, 2021)).

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I. Background

Under PUC Subst. R. 25.505(g), at the beginning of each year, the system-wide offer cap is set to the high system-wide offer cap (HCAP) of $9,000 per megawatt-hour (MWh) to ensure that a resource is incentivized to come online, even under tight conditions. When the peaker net margin (PNM), which serves as a measure of how much net revenue a hypothetical gas generator might have earned in a year, exceeds three times the cost of new entry, the system-wide offer cap is reset to the LCAP, which is set daily at the greater of $2,000 or 50 times the Katy hub price for natural gas, referred to in the ERCOT Protocols as the Fuel Price Index (FIP). Once implemented, the LCAP remains in place for the remainder of the calendar year.

Due to the extensive, multi-day ERCOT emergency event and associated scarcity conditions experienced during the February 2021 extreme winter weather event, there have already been several days of continuous $9,000/MWh pricing experienced this calendar year, and the threshold for transitioning into the LCAP was reached on February 16, 2021. However, at the March 5, 2021 Open Meeting, the Public Utility Commission of Texas (Commission) noted concerns with how the LCAP might affect summer resource adequacy and directed Commission Staff to open a project to request comments addressing these concerns.

II. Adjustments to the LCAP should be limited to providing a maximum price to further protect consumers through the remainder of the calendar year consistent with the original intent of the LCAP.

The system-wide offer cap structure that includes both a HCAP and a LCAP was implemented to "balance two competing concerns: providing generation and load resources a reasonable opportunity to cover their fixed costs over time and protecting load from excessive transfers of wealth to generators during periods of low reserve margins."[2] At the beginning of each year, the HCAP, particularly in its role as the default value, serves to maintain incentives for resources to operate during scarcity conditions, typically during the hottest summer days and coldest winter days, either through new construction or through capital expenditures to improve the operational availability of existing resources, while still providing some predictability for load

[2] *Rulemaking on Wholesale Electric Market Power and Resource Adequacy in the ERCOT Power Region*, Project 31972, Order Adopting Amendment to §25.502, New §25.504 and New §25.505 as Approved at the August 10, 2006, Open Meeting at 73 (Aug. 23, 2006).

by providing a price ceiling. The LCAP mechanism acts as to protect customers from unnecessarily high scarcity prices during a single calendar year by lowering the price ceiling when generators have received revenues well in excess of their operational costs for that calendar year. The LCAP, once triggered, also sends a strong message to potential investors that more resource capacity is needed so that new resources will be constructed and brought on-line to ensure adequate resource adequacy.[3]

Current market conditions match exactly what the LCAP mechanism was designed for – the PNM has exceeded the cost of new entry well over three times[4], meaning that existing resources, including natural gas generation, have been provided an opportunity to earn a reasonable return on investment and sending a strong signal for additional resources to come online or improve availability during scarcity conditions. TPPA recognizes that abnormal fuel costs impacted the return on investment for some generators, but even assuming exceptional operational costs experienced during the event due to high gas prices, the threshold of $315,000 would have been reached for a continually operating unit if they received the real-time price of energy that reflected the price adders built into the existing scarcity pricing mechanism.[5] Further, if generators experience exceptional operational costs, including fuel costs, during the rest of the calendar year, ERCOT has the ability to commit those units using the reliability unit commitment (RUC) process under ERCOT Protocols § 5.5.2 which then enables the generators to be "made whole" by submitting verifiable costs, including actual fuel costs.[6] .This is similar to the provisions related to exceptional fuel costs for resources subject to the Mitigated Offer Cap (MOC) under ERCOT Protocols § 4.4.9.4.1 when constraints exist in the system that are non-competitive. While the purpose of this provision is distinct, the outcome is similar, the resources are made whole. During the February 2021 extreme winter weather event multiple resources subject to MOC submitted

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[3] ERCOT has previously projected that capacity is unlikely to be a concern for this coming summer. ERCOT's latest Capacity, Demand, and Reserves (CDR) Report forecasts a 15.5% planning reserve margin for summer 2021. This preliminary analysis is anticipated to be updated in the final CDR Report release scheduled for May 6. The preliminary summer Seasonal Assessment of Resource Adequacy (SARA) is expected to be released on March 25. *See Report on the Capacity, Demand and Reserves (CDR) in the ERCOT Region, 2021-2030*, ERCOT (Dec. 16, 2020). http://www.ercot.com/content/wcm/lists/197379/CapacityDemandandReservesReport_Dec2020.pdf

[4] As of March 12, 2021, ERCOT reports the PNM value to be $708,273/MW, assuming 10 times the fuel price index at the Katy hub, well in excess of the current trigger for LCAP of $315,000/MWh based on three times the cost of new entry.

[5] Assuming operational costs of $5,000/MWh, a continually operating unit could have received revenues of $320,000/MWh over the course of February 16 to February 19 for the hours in which prices were set at $9,000/MWh.

[6] ERCOT Nodal Protocols Section 5.5.2 Reliability Unit Commitment (RUC) Process (Mar. 15, 2021). http://www.ercot.com/content/wcm/libraries/227367/March_15__2021_Nodal_Protocols.pdf

exceptional fuel costs requests.[7] These same processes, RUC and exceptional fuel costs for MOC, will still exist for this summer if costs exceed the LCAP.

TPPA also recognizes that some resources were unavailable, and some market participants had to purchase energy off the spot market to meet existing obligations, however, the entire purpose of the scarcity pricing mechanism is to ensure resources are available during scarcity events by simultaneously providing an incentive through price adders and penalty through lost potential revenues (i.e., opportunity cost). Any modifications to the existing LCAP that do not benefit consumers would be antithetical to the purpose of the LCAP. Neither of these situations above justify the Commission undoing the existing regulatory structure and placing additional burden on customers of all types to potentially incur even greater costs this summer than were already incurred during the February 2021 extreme winter weather event.

However, there is one adjustment that TPPA recommends that is intended to further protect consumers in light of potential shortcomings of the existing LCAP formula highlighted by the February 2021 extreme winter weather event. Prior to this event, it was not anticipated that the LCAP would result in prices higher than the HCAP value of $9,000/MWh. However, had the LCAP not been suspended during the event, prices would have exceeded almost $18,000/MWh on February 18 due to the FIP exceeding $350/MMBTU. This would have been in misalignment with the intent of the LCAP and demonstrates one of several reasons why the Commission's order suspending the LCAP was necessary during the event. While high gas prices of the magnitude experienced during the event have been extremely rare and perhaps even unprecedented, and gas supply tends to be less constrained during the summer months, it is still possible that the LCAP could result in prices higher than $9,000/MWh this summer during another extreme event such as a hurricane or other natural disaster that creates gas supply shortages. Thus, the LCAP formula should be modified to be calculated as the greater of $2,000/MWh or 50 times the FIP but not to exceed $9,000/MWh. In other words, if an event similar to that which occurred on February 18, the cap would not exceed $9,000/MWh even if 50 times the FIP pushed it beyond that amount while the LCAP is in effect. This is consistent with the foundational principle of the system-wide offer cap that consumers would be willing to pay up to $9,000/MWh to avoid loss of load (i.e., the value of lost load, or VOLL), but no more.

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[7] *E.g.*, http://www.ercot.com/services/comm/mkt_notices/archives/5229

III. The existing LCAP formula with a $9,000/MWh maximum price for extreme events will provide needed post-winter predictability and relief to load-serving entities.

Load-serving entities (LSEs), such as the MOUs that TPPA represents, faced unprecedented costs during the February 2021 extreme winter weather event. As noted in testimony before the Texas Senate Business and Commerce Committee on March 4, 2021,[8] in order to keep needed natural gas generation resources online, one MOU was forced to pay gas prices up to 154 times the amount it paid just a few days prior.

Maintaining a $2,000/MWh LCAP with an additional $9,000/MWh maximum price for extreme events when gas prices could again result in an LCAP greater than $2,000/MWh will provide some degree of regulatory certainty to all load-serving entities, including MOUs, electric co-operatives, and retail electric providers and protect their customers from volatility and unnecessarily high scarcity pricing. It is unlikely that scarcity prices will remain high for any unusually sustained time period as occurred during the February 2021 extreme winter weather event. The Independent Market Monitor's most recent State of the Market Report showed only about seven hours where prices exceeded $3,000 in 2019.[9] However, given the dramatic effects that this market has just experienced, the LCAP with this additional maximum price protection would provide much-needed predictability and relief for load-serving entities and their customers by ensuring that they will not have to bear the brunt of another round of unnecessarily high scarcity prices.

IV. If the Commission considers more extensive changes to the existing scarcity pricing mechanism, further analysis should be conducted and such changes should not be effectuated until January 1, 2022, at the earliest.

The LCAP's current value has been in place since October 2012 and the concept has been in effect since 2006. Comments on this project are due on March 26, 2021, and summer weather (and therefore summer demand) can arrive as early as May, less than two months from now. TPPA

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[8] Hearing on Financial Impacts to the Electric Grid and Market Participants Resulting from the Extreme Cold Weather Outages over February 14, 2021 to February 19, 2021 before the Texas Senate Business and Commerce Committee, 87th Leg., R.S., Testimony of Joe Hegwood, CPA, Chief Financial Officer, City of Bryan and Bryan Texas Utilities (Mar. 4, 2021).

[9] *Reports of the Independent Market Monitor for the ERCOT Region*, Docket 34677, 2019 State of the Market Report for the ERCOT Electricity Markets at 18 (Jun. 1, 2020).

is concerned that there may not be sufficient time to fully consider the effects of any other adjustments to the LCAP if not intended to protect consumers through a direct price cap. To the extent that the Commission chooses to re-examine the scarcity pricing mechanism more holistically, the Commission should use this rulemaking to do so and request more in-depth analysis be completed by ERCOT or a third-party consultant with a presentation of various options prior to taking additional comments.[10] Any restructuring of the scarcity pricing mechanism beyond the price control recommended above for the LCAP should be discussed over a longer period of time and implemented with enough lead time for the market to make necessary adjustments.

The LCAP's current value represents the established rules of the game, known to all market participants. Generation (i.e., resource and qualifying scheduling entities) and load serving entities have built that value into their procurement strategies and bilateral contracts. Any adjustment beyond the one recommended above would create undue harm to consumers and market participants and create additional market uncertainty and turmoil. Certainty around the applicability of the Commission's market rules is essential to a stable market that attracts investment capital. Any decision regarding fundamental pricing rules can have dramatic effects on the confidence of long-term investments in this market, and TPPA believes that these decisions should be made in full collaboration with stakeholders.

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[10] For example, it would be valuable to review and re-evaluate the assumptions used in the most recent third-party report that evaluated the existing scarcity pricing mechanism released in January 2021 in light of the recent event. (*See Estimation of the Market Equilibrium and Economically Optimal Reserve Margins for the ERCOT Region for 2024,* Astrape Consulting, Prepared for ERCOT (Jan. 15, 2021).
http://www.ercot.com/content/wcm/lists/219844/2020_ERCOT_Reserve_Margin_Study_Report_FINAL_1-15-2021.pdf

V. Conclusion

TPPA appreciates the opportunity to submit these comments and urges the Commission to retain the LCAP for this coming summer with the customer-focused adjustment recommended above in light of the shortcomings of the formula during extreme, unforeseen circumstances as highlighted during the February 2021 extreme winter weather event. As always, TPPA looks forward to working with the Commission, its staff, and the stakeholders on these important questions.

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Respectfully,

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