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ISSUES RELATED TO THE
STATE OF DISASTER FOR THE
FEBRUARY 2021 WINTER
WEATHER EVENT

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PUBLIC UTILITY COMMISSION

OF TEXAS

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**COMMENTS REGARDING
THE IMM'S RECOMMENDATIONS**

South Texas Electric Cooperative, Inc. ("STEC") files these comments in response to the letters filed by the Independent Market Monitor ("IMM") in this project on March 1, 2021 (the "IMM's First Letter") and March 4, 2021 (the "IMM's Second Letter") (together the "IMM Letters") which seek to revise rules after parties have transacted and would harm market participants that prepared for events like the winter storm.

I. STEC'S COMMENTS

The IMM Letters improperly recommend that the Commission make decisions to revise market outcomes that were unfavorable to some market participants. However, despite the IMM's assertions, these recommendations are not billing or price corrections. Instead, these are retroactive policy changes that would further destabilize the ERCOT market, cause investment to flee the market, harm market participants that relied upon existing market rules to manage financial risk and impede ERCOT's ability to maintain the reliability of the electric grid.

In addition, repricing would violate Article I, Section 16 of the Texas Constitution, which states that "[n]o bill of attainder, ex post facto law, retroactive law, or any law impairing the obligation of contracts shall be made."¹ Courts have concluded that ratemaking is a legislative activity, even when delegated to an administrative body, and therefore, "rates set after an agency hearing generally must have a prospective effect, just as would laws enacted by the legislature."² The same reasoning and limitations should apply to the Commission when making real time and ancillary services pricing decisions after those markets have closed and market participants have relied on the rules in effect at the time of the transaction.

¹ Tex. Const Art 1 § 16.

² *City of El Paso v. Public Utility Commission of Texas*, 839 S.W.2d 895, 917 (Tex. App.—Austin, 1992).

A. STEC's PREPARATORY ACTIONS FOR WINTER 2020-2021 AND WINTER STORM EVENT

As a long-standing generation and transmission electric cooperative providing wholesale electric service to its eight member distribution cooperatives ("Members"), STEC has taken a conservative approach to risk mitigation. For the past decade, STEC has maintained generation capacity in excess of its forecasted load. Maintaining this generation, often at a loss to STEC, has served as an insurance policy to protect STEC and its Members from the price volatility of scarcity conditions in an energy-only market. STEC's Members and their customers paid higher rates for this insurance policy for years. Repricing energy or ancillary services that were transacted for during the winter storm will be punitive for market participants like STEC that have made, and continue to make, responsible risk-averse investments based on market rules.

In addition to the long-term actions that STEC has taken to mitigate financial risk, STEC took extra precautions in the weeks and days ahead of the winter storm. Following the cold weather event in 2011, STEC improved its weatherization planning and preparations conducted at each of STEC's three owned power plants. Each plant now has a detailed, site-specific plan for protecting facilities against cold weather events, including annual, monthly, and daily site-specific activities triggered by time and the forecast severity of the cold weather event. STEC began undertaking preparatory actions for Winter 2021-2021 in the Fall of 2020, including the implementation of its Winter Weatherization plans at its facilities.

Near the end of January, STEC's contracted weather forecasting service began seeing indications of a strong cold weather event in mid-February, likely to occur beginning February 12. In response, STEC began undertaking preparatory actions for the winter event by: increasing its hedged gas volumes; deferring or cancelling all planned maintenance for its generation resources and delaying planned transmission outages; securing emergency fuel supplies; checking generation and transmission equipment; securing the emergency release of water at a hydroelectric facility to ensure the provision of around-the-clock power during the event; securing Mexico's share of hydroelectric facilities' output for peak demand periods; and posting additional collateral with ERCOT.

These effect of these actions, under the rules in effect at the time decisions were made by STEC, would leave STEC and its Members effectively net neutral to the winter event from a

financial impact perspective. Any market participant that seeks to reprice, seeks to take the very real costs incurred to serve that market participant and shift those costs back to the market participants, like STEC, that stepped up during the event and in the many years leading up to it, to make generation available for financial protection, even though STEC was not permitted to provide the generation its Members paid for to its Members during the event as a result of the rolling outages.

B. THERE IS NO \$16 BILLION OVERCHARGE

The IMM erroneously states that maintaining the HCAP (the High Offer Cap that limits offers for energy to \$9,000 MWh) for the 32-hour time period after the last load shed instruction was recalled “resulted in \$16 billion in additional costs to the ERCOT market.”³ The \$16 billion in overcharges in the market is a myth. No entity, and certainly not the IMM, knows what hedges were put in place by responsible parties to avoid the risk of incurring scarcity pricing charges. The vast majority of power that is generated and delivered on a day-to-day basis in the ERCOT market is not purchased in the Real-Time Market or even in the Day-Ahead Market. It is purchased in the bilateral markets or through other markets such as the Intercontinental Exchange.

An extremely high percentage of the market is hedged through bilateral transactions that the IMM, the PUCT, or ERCOT are not privy to. In the 2019 State of the Market Report, the IMM stated that “the percentage of real-time load hedged dropped slightly to 87% in 2019.”⁴ meaning that close to 90% of the market is not exposed to the real-time price. Market participants also seek to hedge at higher levels in advance of weather events, so that number could be much higher. In any case, assuming the same 87% hedging level, the total exposure to the market would be \$2.08 Billion, less than the current amount ERCOT reflects as being short paid to generators that performed during the winter event. Although it may appear that many loads are still subjecting themselves to greater risk by not locking in a day-ahead price, other transactions or arrangements outside of the organized market are used to hedge real-time prices, including the use of financial instruments such as Point-to-Point Obligations that allow market participants to hedge real-time congestion costs. Only companies that rode the market without hedging their risks outside of the

³ *Issues Related to the State of Disaster for the February 2021 Winter Weather Event*, Project No. 51812, Potomac Economics’ Second Letter to the Commission at 2 (Mar. 4, 2021).

⁴ Potomac Economics’ 2019 State of the Market Report for the ERCOT Electricity Markets, Figure 21, at 35-36 (May 2020).

market paid \$9,000/MWh. The \$16 billion figure offered by the IMM was a calculation of the market value of the total amount of energy generated and delivered during the 32-hour window and is not representative of the dollars that switched hands between hedged counterparties.

C. COMPANIES KNEW ANCILLARY SERVICES WERE NOT CAPPED

The market rules, both PUCT Rules and ERCOT Protocols, do not cap ancillary services prices. ERCOT even reminded market participants that there is NO CAP on ancillary services (in contrast to the \$9000 offer cap on energy). The market rules adopted at the PUCT specifically contemplated the OFFER cap for energy, with prices floating ABOVE THE OFFER CAP for ancillary services. Ancillary services prices increase to the shadow price, per the PUCT Rules, so as to pay the opportunity cost to get the last MW available of ancillary services. This is very different from a PRICE cap, and was intended to be different so that the value of providing the next MW of ancillary services could be accurately calculated, and was designed to exceed the offer cap if necessary to procure the next MW of needed capacity. Market Participants should have planned for all of the pricing risks and obligations in their business—not ask for repricing when they don't like the outcome.

D. REPRICING BENEFITS COMPANIES THAT TOOK RISKS, NOT CONSUMERS

Repricing the market would only benefit unhedged companies, and in many instances not their consumers that pay fixed prices locked into retail contracts. The market was designed to discipline companies that do not hedge. Customers pay under their contracts and those companies cannot pass off their losses to those customers. That is how a competitive market is supposed to work—the risk is borne by the company, not the consumer. As a result, unhedged companies chose to risk riding the market and now ask for repricing to allow them to retroactively cover for the risks they chose to take.

E. INVESTMENT WILL FLEE A MARKET THAT REPRICES

Market Participants expect certainty when transacting in the ERCOT Market. Any Commission decision to change the rules of the game at this juncture would cause irreparable harm to Market Participants. Market Participants acted in reliance of Commission rules, ERCOT rules, and the Commission's emergency orders during the winter storm events. The Commission

specifically addressed the harm of retroactive repricing of the market twice and declined to retroactively reprice the load shed intervals where prices fell below the HCAP.⁵ The Commission found that retroactive pricing is punitive and disruptive to the market. The Commission was correct, and its reasoning remains true.⁶

It is imperative for market participants to be able to rely on the prices offered and accepted in the Day Ahead Market and Real-Time Market. Retroactive market intervention is particularly inappropriate here because the Commission had an opportunity to act to adjust both the energy and ancillary service pricing prior to market participants engaging in market transactions. In the case of energy repricing, ERCOT's decision to continue use of the HCAP throughout the duration of EEA3 was made public in a market notice on Feb. 18, 2021.⁷ The Commission and the IMM were on notice that prices remained at the HCAP. If the Commission or the IMM had concerns about ERCOT's continued use of the HCAP, the time to raise those concerns was on February 19. Instead, the IMM waited a full two weeks to recommend repricing. The IMM made its recommendation after the market has cleared, after presenting at the ERCOT Board of Directors meeting, after market participants have filed bankruptcy, and after numerous legislative committee hearings on the market impacts of the winter storm. The IMM's failure to timely act is a failure to meet the statutory obligations of "recommending measures to enhance the efficiency of the wholesale market."⁸ Rather than enhancing efficiency, the IMM's proposal to reprice energy injects an unprecedented level of turmoil into the market. As Chairman D'Andrea remarked, there is no way to "unscramble this egg."⁹

Investment will flee a market that experiences government intervention and retroactively changes prices after transactions were entered into and have settled. Uncertainty in any financial market undermines the fidelity of that market thereby resulting in a lack of future investment or higher costs to participants to offset the threat of future government intervention. Repricing may also penalize those that hedged on the Intercontinental Exchange ("ICE") market and in the

⁵ Order Directing ERCOT to Take Action and Granting Exception to Commission Rules, Project No. 51617, *Oversight of the Electric Reliability Council of Texas* (Feb. 15, 2021); *see also* Discussion of Emergency Agenda, *Open Meeting of the Public Utility Commission of Texas* (Feb. 16, 2021).

⁶ *Id.*

⁷ ERCOT Market Notice M-C021521-04, *ERCOT Expectations Regarding Exiting EEA and Public Utility Commission Emergency Orders Affecting ERCOT Market Prices* (Feb. 18, 2021).

⁸ Public Utility Regulatory Act, Tex. Util. Code Ann. § 39.1515(a) and (f) ("PURA").

⁹ Discussion of Agenda Item No. 22, *Open Meeting of the Public Utility Commission of Texas* (Feb. 16, 2021) http://www.adminmonitor.com/tx/puct/open_meeting/20210305/.

bilateral/contractual markets. Under such hedging agreements, a generator is paid a fixed price per MW of energy produced, and in return the generator pays the counterparty the price differential when the real-time price of energy exceeds the fixed price. If the Commission retroactively reprices energy, market participants that responsibly hedged their risk must still pay the original published prices when there is now no recourse for collection due to repricing. We understand that ICE has affirmatively stated that it will not reprice if ERCOT prices are changed and is being barred from doing so by the Commodities Futures Trading Commission. The repricing of the ERCOT market after trading will place hedges underwater and entities that would have previously transacted hedges through those mechanisms will avoid doing so for the ERCOT market.

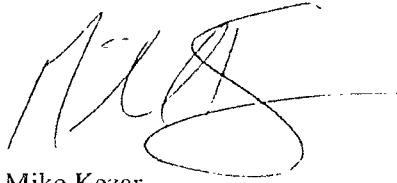
This market was constructed to encourage hedging, and the failure of some to hedge will result in the market disciplining them in times such as these. Repricing energy shifts the costs and benefits among market participants, with some parties unjustly benefitting at the expense of other parties. In the same vein, repricing ancillary services provided during emergency conditions likewise harms market stability. The pricing rules for ancillary services are set out in both PUCT rules and the ERCOT Protocols.¹⁰ They have been fully vetted by market participants, the IMM, and the Commission. The extended emergency conditions of the winter storm event revealed many reliability and market structures that need review. The appropriate avenue for addressing market concerns regarding ancillary service pricing is through the legislative, commission and stakeholder process to change market rules prospectively.

Repricing energy and ancillary services will likely cause generation to exit the market and hinder planned and future investment in a market that so clearly needs additional generation. While many market participants have sympathetic claims for relief, repricing energy or ancillary services does not help the consumers it seeks to help, and in fact it harms the consumers served by hedged, responsible market participants and further destabilizes the market, rather than providing a solution to current market instability.

¹⁰ See 16 TAC § 25.501(a) and (k); ERCOT Nodal Protocols Sec. 6.3.2.

STEC appreciates the opportunity to provide these comments to the Commission.

Respectfully Submitted.

A handwritten signature in black ink, appearing to read 'Mike Kezar', with a long horizontal line extending to the right.

Mike Kezar
General Manager
South Texas Electric Cooperative, Inc.

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