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PROJECT NO. 51871

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

COMMENTS OF TEXAS ELECTRIC COOPERATIVES, INC.

Texas Electric Cooperatives, Inc. (TEC) respectfully submits these comments in response to the Public Utility Commission of Texas (Commission) Proposal for Publication (PFP) of amendments to §25.505, as approved at the May 6, 2021 Open Meeting. TEC is the statewide association of electric cooperatives operating in Texas, representing its members except as their interests may be separately represented.[1]

I. Summary of Comments

The Commission's proposed amendments modify the value of the low system-wide offer cap (LCAP) by eliminating a provision in §25.505(g)(6)(A) that ties the value of LCAP to the natural gas price index value. The PFP also establishes §25.505(g)(7), which institutes a make-whole provision for marginal costs incurred in excess of real-time revenues during an event when the LCAP is in effect. TEC believes the intent of these changes is to decouple the LCAP from the natural gas price index value, to address instances where excessive natural gas prices may result in wholesale electricity prices that exceed the high system-wide offer cap (HCAP). Because

[1] TEC's 75 members include distribution cooperatives that provide retail electric utility service to approximately 4,000,000 consumers in statutorily authorized service areas that encompass more than half of the total area of the state. TEC's G&T members generally acquire generation resources and power supply for their member distribution cooperatives and deliver electricity to them at wholesale.

generators may incur costs above $2,000/MWh during a scarcity event, the make-whole provision allows generators to recover these costs after the event.

TEC supports the Commission's amendment to §25.505 to address potential prices in excess of the HCAP. However, instead of a make-whole provision, TEC recommends the LCAP continue to be set at the greater of $2,000/MWh or a value tied to the natural gas price, but at a lower multiplier than that currently in effect. While the lower multiplier will make it less likely that marginal prices rise to levels above $9,000/MWh, the LCAP should still be capped at a level not to exceed the HCAP.

TEC provides comments below on the market implications of the make-whole mechanism. TEC's comments focus on how the make-whole provision interacts with excessive gas costs, the short- and long-term implications of the make-whole provision, and the circumstances in which reimbursement for operating losses comes into play. While TEC understands the need to amend the rule to address potential prices in excess of the HCAP, the 87th Legislature may provide guidance on this issue. TEC recommends the Commission consider waiting until relevant legislation is signed into law and then seek public comment, so that any amendments to the rule contemplate direction received from the Legislature.

II. A Make-Whole Provision May Result in Escalating Fuel Costs

Under the Commission's proposed §25.505(g)(7), resources would be reimbursed for any operating losses sustained during an event when the price is set at the LCAP. By shifting fuel costs out of the price and into a side payment, generators would be guaranteed cost recovery for excessive fuel costs and those costs would not be reflected in the real-time price. The real-time price would be limited to $2,000/MWh, regardless of excessive fuel costs or other production costs. However, TEC notes that guaranteed cost recovery may result in actual costs that are much higher than the LCAP. During periods of excessive fuel costs, costs to load may exceed even the $9,000/MWh high system-wide offer cap (HCAP), because gas providers will know that no matter what they charge, these costs will be reimbursed. During the February event, it is possible that the $9,000/MWh offer cap in ERCOT served as a ceiling to the competitive bidding of natural gas. By allowing costs in any amount above $2,000/MWh to be reimbursed, TEC believes the proposed rule may result in escalating fuel costs during an emergency.

TEC understands the Commission does not have jurisdiction over the natural gas market, and its wholesale market rules are not designed with the intention of disciplining fuel costs. However, the Commission's rules should not implicitly permit runaway fuel costs. Offers must therefore be capped at the HCAP to avoid costs to load that may rise without limit. Because TEC believes, consistent with market principles, that costs should be reflected in the price to the greatest extent possible, TEC recommends the LCAP continue to be set at the greater of $2,000/MWh or a multiplier of 15 times the natural gas price index value (or some other value lower than the current multiplier of 50). The rule should specify that offers may not exceed the HCAP. A ceiling is needed to prevent escalating fuel costs.

TEC further recommends the Commission address gas supply shortages in the areas it has jurisdiction – by prohibiting critical gas infrastructure from participating in the wholesale market during emergencies as Load Resources or in the Emergency Response Service program at ERCOT, unless such load has a reliable and proven alternative capability to continue to operate its processes. Critical gas supply chain infrastructure must not be compensated to shed load and exacerbate a gas shortage, which contributes to extraordinary gas costs and power costs during an emergency.

III. A Make-Whole Provision May Affect Short-Term Reliability and Long-Run Resource Adequacy

Under the Commission's proposed amendment, offers would be constrained to \$2,000/MWh, even when actual costs exceed that amount. TEC believes resource owners may not be incented to acquire high-cost gas unless they were guaranteed both complete cost recovery plus a margin. Should units determine that it is uneconomic to purchase gas, less generation may be available, resulting in greater load shed during emergencies. While ERCOT has the authority to commit units via a Reliability Unit Commitment (RUC) process, if the generator has not purchased gas, the generator may be in gas outage and unavailable to ERCOT.

Further, certain load reduction programs are currently designed based on a Value of Lost Load (VOLL) assumption set at \$9,000/MWh. Capping the price at something lower could result in less demand response and less capital being invested to create additional demand response programs. The design of the ERCOT market contemplates that high prices during scarcity conditions will supply the additional margins necessary to support investment in generation resources and demand response. Absent other structural changes to the market design, TEC recommends that the LCAP continue to be linked to the natural gas price, to allow prices to reflect the marginal costs of production.

Marginal cost pricing is the preferred approach because it sends the correct signals to generators and loads. TEC believes the market rules should endeavor to minimize make-whole payments, which require manual settlement processes that may cause delays, leading to possible credit issues. Make-whole payments also create unhedgeable uplift for load. If the LCAP continues to reflect fuel costs, TEC does not believe a make-whole provision is needed.

However, if the Commission retains the provision and caps prices at $2,000/MWh, rather than referring to marginal costs in §25.505(g)(7), TEC proposes a reference to verifiable costs that are equal to or greater than what a unit would receive from a RUC. This change would make the unit indifferent to offering into the market or being brought online through a RUC instruction. Because verifiable costs include a multiplier intended to provide an appropriate margin to the resource, TEC believes a make-whole payment equal to or greater than that received from a RUC would address some of the concerns around unit availability during these scarcity events.

IV. Conclusion

As described in these comments, rather than a make-whole payment provision, TEC recommends the LCAP be set at the greater of $2,000/MWh or 15 times the natural gas index value and be capped at the HCAP. The Commission should also wait to proceed with this rulemaking until any legislation addressing this subject is signed into law. TEC appreciates the opportunity to submit these comments and thanks the Commission for its consideration.

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Respectfully submitted,

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