PROJECT NO. 51871

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

<u>SOUTH TEXAS ELECTRIC COOPERATIVE, INC.'S INITIAL COMMENTS</u>

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

COMES NOW, South Texas Electric Cooperative, Inc. ("STEC") and submits the following Initial Comments to the Public Utility Commission of Texas' ("PUCT" or "Commission") *Proposal for Publication of Amendments to § 25.505 as Approved at the May 6, 2021 Open Meeting.* The deadline for the filing of Initial Comments to be considered in the above-styled proceeding is June 3, 2021, therefore these Initial Comments are timely filed.

I. PROPOSED RULE AMENDMENTS

A. STEC Opposes the Proposal to Eliminate the LCAP Fuel Index Price Multiplier in Subsection (g)(6)(A)

STEC supports the Commission's proposal to retain the low system-wide offer cap ("LCAP") at $2,000/MWh but recommends that the Commission also maintain a fuel index price multiplier as a market-based component of the LCAP calculation. STEC recommends, however, that the 50 times fuel index price multiplier component be lowered to a much lower multiple, though one that is sufficiently high enough to allow for full cost recovery by the most inefficient gas-fired resource in ERCOT.

Maintaining a fuel index price multiplier supports reliability and market stability because it incentivizes generation providers to lock-in and control their fuel costs. Modifying, rather than eliminating, the fuel index price accomplishes the goal of protecting consumers from sustained high prices while continuing to send beneficial market signals and mitigating the need for a

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make-whole mechanism with its associated uplift allocation concerns. If the price of natural gas were to float at prices at or above the LCAP, the lower fuel index price multiplier would reward entities that acted responsibly to procure forward gas at a hedged price. Having a market component of fuel costs incentivizes generators to avoid the risk of fuel costs spikes during scarcity events and motivates generators to purchase natural gas at the best available price, thereby allowing them to maximize profit opportunities while decreasing costs to loads. Without a fuel index price multiplier, there is no incentive for generation providers to hedge their fuel costs and ensure they are available during scarcity conditions because any costs above $2,000/MWh will be passed through under make-whole provisions potentially with no profit margin. It is important to maintain the natural gas component of the LCAP calculation because natural gas is the marginal fuel for assets that, particularly in times of scarcity, set the market clearing price of energy. Natural gas must be included because "it accounts for changes in the cost of generation caused by fluctuations of the cost of fuel.[1] As a result, the Commission should modify, rather than eliminate the fuel index price multiplier in its entirety.

Should the Commission choose to retain the fuel index price at a reduced multiplier, STEC also recommends that the Commission modify the rule's language to ensure that the LCAP cannot exceed the high system-wide offer cap ("HCAP"). STEC acknowledges that the events of Winter Storm Uri in February resulted in the LCAP being higher than the HCAP because of elevated natural gas prices. STEC recommends that the Commission modify the LCAP to ensure that it is capped at the value of lost load, or $9,000/MWh. This would better align the function of the LCAP with its intended purpose of protecting Texans against high prices once a certain threshold of generator revenues has been met.

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[1] *Rulemaking Proceeding to Address Pricing Safeguards in Markets Operated by the Electric Reliability Council of Texas*, Project No.33490, Order Adopting Amendment to § 25.505 as Approved at the August 16, 2007, Open Meeting at 29 (Aug. 16,2007).

B. STEC's Comments on the Make-Whole Provision in Subsection (g)(7)

Make-whole payments are the antithesis of competitive market revenues, and the use of these mechanisms should be minimized as much as possible. Increased reliance on make-whole mechanisms undermines the fundamental premise of markets that discipline and control costs. Make-whole mechanisms result in inefficient resource commitment and increased, unavoidable costs to consumers. Further, these increased costs often become unhedgeable amounts borne by loads through an uplift mechanism. The Commission, ERCOT, and stakeholders have long recognized the burdens that make-whole provisions impose on customers, and the resulting inefficiencies that undermine a competitive market. The parties have worked diligently to mitigate and minimize the need for make-whole mechanisms in the market. Market mechanisms should instead be used to address market inefficiencies, and achieve the more desired result. As discussed above, a lower gas multiplier removes the need for an out-of-market make-whole mechanism, and corresponding uplift charges.

Should the Commission choose to adopt a make-whole mechanism, however, considerable thought must be given to the mechanism's design and implementation to ensure that make-whole costs are appropriately allocated to loads that should ultimately bear them. STEC posits that any make-whole mechanism should be designed to achieve two goals: (i) to encourage market participants to hedge their market positions, and (ii) to avert punishment of market participants that appropriately hedged their load. STEC believes that the current Reliability Unit Commitment ("RUC") make-whole mechanism would be a potential model to use for the uplift created by the implementation of a make-whole mechanism the to recover the costs related to excessive natural gas prices while achieving the above goals. The RUC mechanism as currently implemented assigns up to two times the cost of the RUC make-whole costs to entities that are short in the market. STEC does not believe it is necessary to have such a multiplier for the uplift of make-whole costs related to excessive natural gas prices but does believe that it provides a solution that will encourage hedging in the market and that can be adapted from existing processes with minimal cost. In the event there are no short entities identified in the market, the goal of encouraging market participants to hedge would have been accomplished, and it would then be appropriate to uplift all make-whole costs across a broader range of market participants. This broader range of market participants could be as narrow as allocating costs only to loads (*e.g.* on a load ratio share basis) or could be as broad as the current default uplift mechanism found in the ERCOT Protocols, which uplifts the costs to all entities that benefitted over time from participation in the market.

II. CONCLUSION

STEC appreciates the Commission's review of these important issues and respectfully requests the Commission's consideration of these Initial Comments.

Respectfully submitted,

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