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

INITIAL COMMENTS OF TEXAS ELECTRIC COOPERATIVES, INC.

Texas Electric Cooperatives, Inc. (TEC) respectfully submits these initial comments in response to the Public Utility Commission of Texas (Commission) Staff request for comments published on March 8, 2021 in Project No. 51871. TEC is the statewide association of electric cooperatives operating in Texas, representing its members except as their interests may be separately represented.[1]

The devastating impact of Winter Storm Uri revealed infrastructure, operational, and structural deficiencies of the ERCOT market that had a profound effect on TEC's member systems and their member-owners. The Legislature, the Commission, and all stakeholders are acutely focused on correcting these defects to ensure the people of Texas never again experience such catastrophic outcomes. While the impacts of the event are still being understood, the performance of the ERCOT market under sustained Energy Emergency Alert (EEA) 3 conditions revealed significant flaws which must be addressed. TEC appreciates the Commission's prompt attention to these issues of primary importance to the ERCOT market and the people it serves.

[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.

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At the Commission's direction, an early step in reviewing the market design involves reevaluating the function of the low system-wide offer cap (LCAP) in the scarcity pricing mechanism established under 16 TAC § 25.505(g). Although TEC believes changes to the scarcity pricing mechanism and broader changes to the market design are appropriate, TEC asks that the Commission consider both market performance under extraordinary conditions and the long-term viability of the market design as it functions during normal conditions in its review.

Responses to Questions Posed by Commission Staff

1. Should the Commission amend its rules to adjust the LCAP?

TEC recommends the Commission amend its rules to adjust the LCAP, because as revealed during the week of February 15th, the LCAP construct cannot fulfill its intended purpose of protecting loads from sustained high prices in unusual situations where the price of natural gas exceeds about \$180/MMBtu (the price at which the LCAP would surpass the high system-wide offer cap (HCAP)). While the Commission contemplated the LCAP exceeding \$2,000/MWh by setting it at the *greater* of \$2,000/MWh or 50 times the natural gas index price, as noted in the Commission's February 16 Order, it defies logic for the LCAP to rise above the HCAP.[2]

TEC is aware of the explanations given as to why the Commission and ERCOT made the choice to disable the LCAP and fix the price at the HCAP during the emergency, since the use of the LCAP would have resulted in prices potentially more than double the level of the HCAP. According to public statements and filings, the Commission and ERCOT took action to address the LCAP anomaly described above, to provide a market incentive for all generation to return to

[2] *Oversight of the Electric Reliability Council of Texas*, Docket No. 51617, Order at 2 (Feb. 16, 2021).

service, and to incent industrial load to remain offline.[3] TEC strongly supports a principled market design with price signals that drive disciplined behavior and operational reliability in both the short term and the long term. Generation made available to capture that price should be rewarded, and ERCOT's contention is that the price was needed to restore the system to normal operations.[4] However, TEC posits that in emergency situations of unknown duration, such as those seen last month, continued pricing at the HCAP can have a devastating impact on entities with even minimal market exposure.

While the LCAP could not function as intended during the event, the intent of the LCAP construct – to insulate loads from excessive costs – should be maintained in some manner going forward.[5] TEC therefore recommends the Commission amend 16 TAC § 25.505(g) to establish a mechanism that provides generators an incentive to be available, supports resource adequacy, and reduces costs for consumers in situations where fuel costs could cause the price to exceed the HCAP. Although, as described below, TEC proposes a general concept for consideration, TEC is open to evaluating other alternatives.

2. ***If the Commission amends its rules to adjust the LCAP, what specific adjustments should it make?***

The Commission last reviewed the LCAP construct in Project No. 48721. This project was opened to address concerns regarding possible discrepancies between pricing outcomes in the Day-

[3] ERCOT Staff Presentation at the Urgent Board of Directors Meeting, Item 2: Market Financial Matters at 2-4 (Mar. 12, 2021).
[4] *Id.*
[5] *PUC Rulemaking to Amend PUC Subst. R. 25.505, Relating to Resource Adequacy in the Electric Reliability Council of Texas Power Region*, Project No. 40268, Order Adopting Amendments to §25.505 as Approved at the October 25, Open Meeting at 31 (Oct. 26, 2012).

Ahead Market and the Real-Time Market caused by divergence between the LCAP and the Operating Reserve Demand Curve (ORDC).[6]

At the time, TEC did not advocate for eliminating the LCAP because TEC believed and still believes that the rules must include a circuit breaker to insulate consumers from sustained high prices. TEC did not envision a situation where the price of natural gas would result in the LCAP exceeding the HCAP, and TEC did not contemplate an outcome where the Commission and ERCOT held wholesale prices at the HCAP for days despite Peaker Net Margin (PNM) revenue rising to over $700,000/MW. Based on recent experience, these extraordinary results are possible unless structural changes are made to the market. Although the Legislature is evaluating changes to prevent these catastrophic outcomes from occurring again, modifications to the scarcity pricing mechanism are needed to avoid potentially profound financial consequences that happened in part because of excessive natural gas prices and the command and control directives issued by the Commission and ERCOT.

In light of these outcomes, the Commission may consider modifying the LCAP construct whereby, during emergencies, prices are set by the ORDC or the Reliability Deployment Price Adder (RDPA) at the HCAP for a period of time, after which prices could be set at the LCAP of $2,000/MWh (or other appropriate price level plus a multiple of the price of natural gas). Considering the excessive gas prices seen during the February event, an LCAP of $2,000/MWh may not be sufficient for generators to recover fuel costs in certain situations. However, TEC recommends prices not be allowed to exceed the HCAP even in instances of excessive fuel costs.

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[6] *Rulemaking Proceeding to Amend 16 TAC §25.505, Relating to Resource Adequacy in the Electric Reliability Council of Texas Power Region and to Repeal 16 TAC §25.508, Relating to the High System-Wide Offer Cap in the Electric Reliability Council of Texas Power Region*, Project No. 48721, Staff Memorandum at 1 (Dec. 13, 2018).

If limitations are placed on how long prices may be set at HCAP during an event, after the event concludes, TEC recommends the scarcity pricing mechanism revert back to the HCAP of $9,000/MWh and not be disabled for the remainder of the calendar year, because of its importance in driving short-term outcomes during scarcity and promoting resource adequacy over time. Should other changes to the market design be implemented to support resource adequacy, the HCAP could be reduced at all times, as generator revenues would not need to be concentrated in these infrequent high-cost periods.

TEC acknowledges that changes to the HCAP/LCAP mechanism create implementation challenges, and TEC anticipates further discussion in a rulemaking proceeding. These comments do not outline a detailed design proposal but describe one option for Commission consideration that should be further vetted. TEC looks forward to further review and deliberation of alternatives.

3. ***If the Commission amends its rules to adjust the LCAP, when should these adjustments take effect?***

TEC asks the Commission to resolve uncertainty around the use of the LCAP this summer as soon as practicable. Whether the Commission pursues further changes to the LCAP or not, the Commission's intent regarding the offer cap in place this summer should be made clear to the market.

Going forward, designing an effective proposal to revise the scarcity pricing mechanism in a manner that avoids unforeseen consequences will take time. Given that changes contemplated by interested parties and the Commission will likely take several months to deliberate, TEC asks the rulemaking be instituted with the goal of implementing these changes by January 2022.

TEC appreciates the opportunity to submit these initial comments and thanks the Commission for its consideration.

Dated: March 19, 2021

Respectfully submitted,

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