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PROJECT NO. 52373

**REVIEW OF WHOLESALE ELECTRIC
MARKET DESIGN**

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**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) Staff request for comment filed in Project No. 52373 on October 26, 2021. TEC is the statewide association of electric cooperatives operating in Texas, representing its members except as their interests may be separately represented.¹

I. Introduction

The threshold question identified in Chairman Lake's memorandum and posited in the Staff request for comment relates to the impact of imposing a capacity requirement on Load Serving Entities (LSEs) in the ERCOT competitive retail market. TEC agrees that the retail choice environment creates complexities and implementation challenges that do not exist in other power regions where bilateral capacity market constructs have been established. Although the majority of TEC's members have not at this time chosen to opt into the competitive retail market², electric cooperatives are LSEs directly implicated by the proposal. Fundamental and unresolved design elements of the construct, including protections regarding retail market concentration and market power abuse, resource accreditation, forward requirements and load forecasting, the bulletin board concept, and the penalty regime will therefore impact all of TEC's members that serve in ERCOT. Further, the costs, implementation timeline, and resource adequacy implications will be dictated by the reliability standard that presumably forms the basis of the obligation, and which has yet to be articulated by the Commission.

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.

² Nueces Electric Cooperative, Inc. is the only cooperative in Texas that has opted into retail competition.

As can be discerned from the technical nature and breadth of the Staff questions, the LSE obligation represents a change of significant magnitude for the market in general and specifically for TEC's member systems. Under the current framework, an electric cooperative's board of directors makes decisions regarding resource acquisition and expansion undertaken by the cooperative; the LSE obligation seems to move this decision-making power from the local cooperative to a central administrator. This aspect of the proposal represents a fundamental change from the status quo for electric cooperatives.

While TEC shares the Commission's goal of adopting a market design that promotes supply stability and moves away from a crisis-based model, given the Commission's target deadline for its market reform blueprint (December 19th), TEC is concerned that fundamental uncertainties regarding the proposal may persist that cannot be adequately addressed in the envisioned timeline. At a minimum, TEC asks the Commission to identify its reliability standard so that the costs and the reliability benefits of the proposal may be estimated before moving forward.

TEC understands and appreciates the Commission's enormous efforts in reforming the ERCOT market design. However, from the perspective of relatively small LSEs directly impacted by a proposal of great complexity, TEC urges the Commission to take a deliberative and measured approach regarding mandatory capacity obligations. A market reform blueprint can move forward this year, implementing the directives of PURA³ §§ 35.004 and 39.159 as established in Senate Bill 3 (SB 3), without an up or down vote on the LSE obligation.

II. Response to Certain Questions

Question 6a: Will an LSE Obligation negatively impact customer choice for consumers in the competitive retail electric market in ERCOT? Can protective measures be put in place to avoid a negative impact on customer choice? If so, please specify what measures.

The LSE obligation does not seem compatible with customer choice and the competitive retail electric market. The challenge, which has been described in detail in filings made in Project

³ Public Utility Regulatory Act, Tex. Util. Code Ann. §§ 11.001-66.016 (PURA).

No. 40000⁴, relates to assigning a forward obligation to an LSE that experiences ongoing load migration and customer switching, creating significant stranded cost risk for the retail provider. Further, an unaffiliated retail electric provider may not be able to secure sufficient credit to arrange supply to meet its obligation. TEC is not aware of any other power region with retail choice in which an LSE obligation has been established. It is therefore difficult to derive lessons learned on this issue from past experience of other regions. The LSE obligation may create barriers to entry that would limit the ability of smaller independent providers to enter the market and compete on price with affiliated market participants.

Although TEC is not proposing a specific measure to avoid a negative impact on customer choice in these comments, TEC will closely evaluate proposals made by the competitive community. This aspect of the design, like others, will require additional consideration and vetting to avoid any detrimental impacts or unintended consequences.

Question 6d: What is the impact of an LSE Obligation on load-serving entities that do not offer retail choice, such as municipally owned utilities or electric cooperatives?

Question 13: What is the estimated market and consumer cost impact if an LSE obligation is implemented in ERCOT? Describe the methodology used to reach the dollar amount.

Without knowing certain fundamental design details of the LSE obligation, the cost impact on LSEs that are electric cooperatives is difficult to estimate. TEC assumes, based on Chairman Lake's memorandum, that the intent regarding the LSE obligation is to require that each entity procure a certain amount of supply to cover their forecast load.⁵ One unresolved question is whether each LSE must also procure an additional amount above the level needed to cover the forecast load (a reserve margin). As inferred from the memorandum, the obligation does not include an amount of capacity in excess of the forecast peak amount. Rather, the memorandum specifies that LSEs must procure an amount equal to their forecast "net peak load," which presumably is less than their total peak, because it is netted by some amount.

⁴ See e.g., Project No. 40000, Comments of the Texas Reliability Assurance Market Advocates at 16-17 (Dec. 16, 2013).

⁵ Docket No. 52373, *Chairman Lake Memo Regarding the ERCOT Market Design* at 2 (Oct. 20, 2021). ("Ensure LSEs procure the electricity they have promised to their customers.")

If the design does contemplate an additional amount of reserves beyond what is required to cover load (based on an as-yet undefined reliability standard), then the proposal would likely increase costs for electric cooperative members. These cost increases would come on top of increases due to changes to the Operating Reserves Demand Curve (ORDC), new Ancillary Services (AS), and the current cost uncertainty related to ERCOT's conservative procurement of additional AS to meet forecast variability. The total cost for electric cooperatives of this set of market design changes may be substantial. TEC strongly recommends the Commission provide clarity on the reliability standard that should form the basis of the LSE obligation so that the cost impact can be understood.

Further, as described in the introduction to these comments, the proposal also introduces a novel approach to supply acquisition and supply monitoring for electric cooperatives. According to PURA § 41.055, the jurisdiction of the board of directors of an electric cooperative includes, among other things, "management and operation of the utility's systems, including exercise of control over resource acquisition and any related expansion programs." Whereas power supply arrangements are currently determined by the cooperative's locally-elected board of directors, under the LSE proposal it appears a centralized administrator would mandate a certain level of resource acquisition. This acquisition would occur bilaterally, and the Independent Market Monitor would be tasked with reviewing a large volume of bilateral trades to guard against market power abuse and price manipulation. Although it is not specified in the memorandum, TEC additionally assumes an entity such as ERCOT or the Commission would review the contracts on a regular basis to ensure the obligations have been satisfied. Currently, for distribution cooperatives associated with a generation and transmission cooperative (G&T), their bilateral contracts are based on a member-owner relationship, and power supply decisions fall within the jurisdiction of the G&T's board of directors. TEC highlights this aspect of the board of directors' purview over resource expansion and the unique character of the member-owner relationship between distribution cooperatives and their G&Ts to emphasize the significance of the change for TEC's member systems and the reluctance of TEC to offer preliminary support for a change of this magnitude without further deliberation.

Finally, extensive discussion has occurred regarding the difficulty for competitive LSEs to manage a capacity obligation given load migration and customer switching. Electric cooperatives would also face issues regarding load forecasting to meet their obligations under the proposal.

Requiring each LSE distribution cooperative, of which there are 44 in ERCOT, to determine their load ratio share of net peak load on a forward basis is not a straightforward task. Understanding a LSE's future load ratio share means estimating the total net peak load expected on the system. Cooperatives may have insight into load growth in their service areas, but approximating that amount as a function of total net peak load requires additional assumptions and conjecture about how the ERCOT system as a whole may evolve. TEC additionally cautions that, if renewables are netted, this may increase our dependence on these resources to perform. TEC posits that one approach to netting could be defining net load as load minus demand response for each LSE. TEC makes these points to emphasize potential challenges and unresolved details associated with the netting approach.

Large load additions that occur on relatively short timelines are a known reality in ERCOT, both in and out of cooperative service areas. Accurate forecasting of both the LSE's load ratio share and the total system net peak load will be problematic for non-opt-in entities as well as competitive providers. Further, should a large load materialize in the cooperative's footprint and there is no additional capacity to procure, it is unclear how an LSE would meet its obligation, which entity would produce the residual capacity, and how the mechanics of the supplemental procurement would function. These undefined aspects of the proposal create significant uncertainty for cooperative LSEs and make it difficult to confidently assess the impact to TEC's member systems.

Question 9: How can the LSE Obligation be designed to ensure demand response resources can participate fully and at all points in time?

TEC agrees with the premise that demand response resources should qualify as resources to meet an LSE obligation. Voluntary, demand-side curtailment has the potential to greatly improve reliability, and certain electric cooperatives have made significant investments in enabling direct load control and other demand-side programs for the benefit of their members.

Currently, the majority of demand response activity in cooperative service areas is based around the 4 coincident peak (4CP) incentive. These programs provide cost savings to cooperative members by avoiding a portion of transmission charges that are ultimately assigned to members' bills. However, over time, as more demand response is implemented and additional loads attempt

to respond to 4CP, it has become more difficult to correctly predict a 4CP day, and the cost savings are diluted. If the LSE obligation is implemented, TEC believes that an electric cooperative should be able to aggregate its demand response as a resource to meet its obligation. Enabling demand-side participation could effectively encourage additional demand response in non-opt-in areas.

While the participation of demand response shows promise, TEC does caution that under the proposal entities will attempt to chase both 4CP and net peak load to avoid certain costs. This potential implication should be further reviewed to better understand if, under the LSE obligation construct, which appears to be based on net peak load, 4CP continues to be the appropriate methodology to allocate transmission costs.

Question 10: How will an LSE Obligation incent investment in existing and new dispatchable generation?

As noted in the response to Questions 6b and 13, Chairman Lake's memorandum specifies that the LSE obligation is a three year forward requirement, and LSEs must procure 100% of their "load share ratio of forecast net peak load" on a scaled basis over the three years. This element of the proposal could be interpreted to require LSEs procure an amount less than their total peak load, because some component is netted out. TEC assumes that aspect of the proposal is intended to address system conditions where intermittent resources are not producing, which generally occurs at a different time than coincident peak system demand.

TEC notes that an obligation to meet an amount of capacity that is less than coincident peak may not produce the additional installed capacity presumably sought by the Commission. Further, if the construct does not include a reliability standard that implies an amount of installed capacity beyond the market equilibrium amount that is a function of load growth and the ORDC, the obligation may not incent additional installed capacity above what would already be expected. If the Commission implements an LSE capacity obligation, it should first articulate a preferred reliability standard on which to base the obligation – this standard will inform the expected amount of additional installed capacity. More details are therefore needed to determine how the design of the obligation could lead to investment in new dispatchable generation.

Finally, the LSE obligation appears to be designed around a system of penalties levied on the LSE for "lack of adequate credits" and levied on the generator for "lack of performance." TEC understands that the intent of these penalties is to create incentives to produce the desired amount

of installed capacity, outside of the pricing signals realized by the energy-only market. TEC cautions that the penalty system could have the unintended consequence of discouraging investment if it is too punitive.

III. The Market Reform Blueprint Can Implement the Directives of SB 3 without an LSE Obligation

The wholesale market reforms envisioned by the Legislature through SB 3 are found in PURA §§ 35.004 and 39.159.⁶ The Commission can address these mandates in its blueprint without incorporating an LSE obligation at this time. PURA § 35.004 directs the Commission to review the type, volume, and cost of ancillary services, evaluate whether additional services are needed for reliability, and ensure that the services are designed in a nondiscriminatory manner consistent with cost causation. PURA § 39.159 relates to ancillary services sourced from dispatchable generation, developed to support reliability during times of system stress.

TEC believes changes to the ORDC that appropriately value the reliability contribution of reserves, the voltage support product, and the winter ancillary services product described in Chairman Lake's memorandum address certain aspects of the relevant directives of the statute. These measures can be included in a blueprint to meet the directives of SB 3 without an LSE obligation, which does not appear in the statute.

IV. Conclusion

TEC and its member systems thank the Commission and its Staff for the opportunity to provide comment on the LSE obligation proposal. As noted in these comments, at a high level TEC is fully supportive of changes to the market design that reduce risk, enhance system resilience, and encourage new investment. Electric cooperatives are community-owned utilities that have been serving rural Texas for over 80 years, and TEC's member systems intend to continue providing this essential service to their consumers. Doing so requires a sustainable ERCOT wholesale market design.

The task of developing changes to the design that effectively and fairly achieve the Commission's goals is a significant undertaking. Given the scope of its administrative complexity, TEC does not believe an LSE obligation should be included in the market reform blueprint.

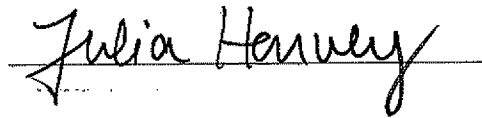
⁶ PURA § 39.160 also establishes wholesale pricing procedures.

Certainly, the technical details embodied in Staff's request for comment cannot be adequately resolved in written comment by November 1. TEC believes the Commission can release a blueprint this year that meets the legislative directs of SB 3 through significant proposed changes to the AS markets and the ORDC. TEC supports continued evaluation of more fundamental, structural changes, including capacity obligations based on an articulated reliability standard, in phase two of the Commission's market reform efforts.

TEC looks forward to continued participation in this project and is available to provide any additional information that may be helpful to the Commission.

Dated: November 1, 2021

Respectfully submitted,

A handwritten signature in black ink that reads "Julia Harvey". The signature is written in a cursive style and is positioned above a horizontal line.

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Texas Electric Cooperatives, Inc. (TEC)
Executive Summary of Comments

Project No. 52373 – Review of the Wholesale Electric Market Design

Introduction

- TEC's member systems share the Commission's goal of adopting a market design that promotes supply stability and moves away from a crisis-based model.
- Electric cooperatives are LSEs directly implicated by the LSE obligation proposal. The proposal represents a change of significant magnitude for TEC's member systems.
- Fundamental uncertainties regarding the proposal persist that cannot be adequately addressed in the envisioned timeline.
- The market reform blueprint can move forward without an LSE obligation.

Impacts on the Retail Market

- The LSE obligation does not seem compatible with customer choice and the competitive retail electric market. The challenges relate to load migration, customer switching, and credit requirements.
- The proposal would likely reduce the competitive nature of the market.
- A functioning, robust, and diverse retail market provides benefits to non-opt-in entities.

Impacts on Electric Cooperatives and the Costs of the Proposal

- Without knowing certain fundamental design details of the LSE obligation, the cost impact on LSEs that are electric cooperatives is difficult to estimate.
- If the design contemplates an additional amount of reserves beyond what is required to cover load (based on an as-yet undefined reliability standard), then the proposal would likely increase costs for electric cooperative members. The costs in aggregate could be substantial.
- The proposal introduces a novel approach to supply acquisition and supply monitoring for electric cooperatives – cooperatives make power supply decisions at the local level.
- Electric cooperatives would also face challenges regarding load forecasting to meet their obligations. Approximating load ratio share as a function of total net peak load requires assumptions and conjecture about how the system may evolve.
- Should a large load materialize in the cooperative's footprint and there is no additional capacity to procure, it is unclear how an LSE would meet its obligation, which entity would produce the residual capacity, and how the mechanics of the supplemental procurement would function.
- These unknowns make estimating the cost impact on cooperatives highly uncertain.

Integrating Demand Response into the LSE Obligation

- Demand response resources should be eligible to participate as resources in the LSE obligation.
- Currently, the majority of demand response activity in cooperative service areas is based around the 4CP incentive.
- As 4CP becomes more difficult to predict, enabling demand-side participation could effectively encourage additional demand response in non-opt-in areas.
- However, entities will chase both 4CP and net peak load to avoid certain costs. The interaction of these incentives and the 4CP construct in general should be evaluated.

Incenting Investment in Dispatchable Capacity under an LSE Obligation

- The proposal specifies that the LSE obligation is a three year forward requirement, and LSEs must procure 100% of their “load share ratio of forecast net peak load” on a scaled basis over the three years.
- This element of the proposal could be interpreted to require LSEs procure an amount less than their total peak load, because some component of the load is netted out.
- An obligation to meet an amount of capacity that is less than coincident peak may not produce the additional installed capacity presumably sought by the Commission.
- The Commission should articulate a preferred reliability standard on which to base the obligation – the standard will inform the amount of additional installed capacity.

The Market Reform Blueprint Can Implement the Directives of SB 3 without an LSE Obligation

- SB 3 directs the Commission to establish ancillary services sourced from dispatchable capacity that support reliability.
- The proposed significant changes to the AS market and the ORDC adjustments would satisfy this directive.

Conclusion

- TEC supports changes to the market design that reduce risk, enhance system resilience, and encourage new investment. TEC’s members rely on a sustainable wholesale market.
- Given the scope of its administrative complexity, TEC does not believe the LSE obligation should be included in the market reform blueprint.
- TEC supports continued evaluation of fundamental, structural changes to the market, including capacity obligations based on an articulated reliability standard, in phase two of the Commission’s market reform efforts.