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PROJECT NO. 52373

REVIEW OF WHOLESALE ELECTRIC § BEFORE THE
MARKET DESIGN § PUBLIC UTILITY COMMISSION
§ OF TEXAS

COMMENTS OF THE R STREET INSTITUTE TO THE PUBLIC UTILITY COMMISSION OF TEXAS:

The R Street Institute is a nonprofit, nonpartisan public policy research organization headquartered in Washington, D.C. with an office in Texas. Our mission is to engage in policy research and outreach to promote free markets and limited effective government. We believe in the importance of competition within a regulatory framework based on market efficiency.

R Street appreciates the speed with which the Commission has addressed a wide range of issues, most of which were a direct result of the catastrophe that befell the State during February. The Commission has, in its short tenure, ably addressed weatherization requirements, retail product offerings and complex securitization issues.

We suggest that the time has come to pause and more fully deliberate on the significant market design choices facing the Commission. Fundamental market design changes are not needed to fix anything that went wrong in February, nor will they do anything to minimize the risks of something similar happening this winter. Such changes will be needed to effectively address the changing economics of the resource mix and enable markets to allocate resources based on heterogeneous customer preferences, but this should not be done on a crisis-based timeline.

R Street supports most of the items shown as Phase I items, which include a variety of newly defined ancillary service products. The Electric Reliability Council of Texas (ERCOT) has already been procuring larger quantities of the existing ancillary services since February. These procurements have costs and hopefully have provided commiserate reliability benefits. We note that even excluding the extreme costs from February, 2021 ERCOT ancillary service costs have more than doubled compared to 2020. Through October (excluding February), average cost of the four services procured in the day-ahead market has been \$2.60 per megawatt-hour.¹ Annual ancillary service costs were \$1.00 per megawatt-hour in 2020 and \$2.33 in 2019.² Although ancillary service costs to date have not gotten out of bounds we would urge caution as more services are defined and procured, that the cost of these additional services are justified by the additional reliability benefits provided.

¹ Beth Garza calculations using data posted in Potomac Economics' Monthly Market report.

² 2020 State of the Market report, page vii.

Under Phase II of the Market design proposals, the commission has multiple load side reliability mechanisms to consider, each of which is intended to improve assurances of sufficient supply of dispatchable resources in ERCOT.

There are rarely right or wrong market design options, only choices that have different consequences. Now is the time for the commission to pause and adequately review the trade-offs between the various options being considered.

The commission has helpfully included in its Road Map the list of principles by which any proposal should be evaluated. We suggest that one principle missing for Load-Side Reliability Mechanisms is a defined reliability standard. Without this, the Commission will be unable to assess performance and trade-offs between market design options. We stress that any reliability definition be consistent with economic efficiency, such as reflecting the value of lost load in aggregate and remain cognizant of its variance between customers.

We further suggest that one of the first next steps in evaluating a load side reliability mechanism would be for ERCOT to improve its reliability assessment process and tools. The current Capacity, Demand and Reserves (CDR) and Seasonal Assessment of Resource Adequacy (SARA) processes are not sufficiently robust or rigorous to appropriately assess future reliability risks, specifically those associated with extreme weather and limited or variable energy resources. If the Commission pursues more robust resource procurement to ensure sufficient dispatchable or firm capacity there should be a strong analytical foundation on which to make decisions about how much dispatchable or firm capacity is needed. Regardless of the specific mechanism developed, understanding any reliability deficiencies seems to be the first task.

Once a reliability standard has been established, the next step is to determine what deficiencies may exist between the existing fleet of resources and the standard, the process of evaluating the tradeoffs between different approaches can begin in earnest. The key difference between the Dispatchable Energy Credits (DEC) and Load Serving Entity Obligation (LSEO) alternatives seems to be whether all required resources are procured (LSEO) or just a subset (DEC). As a general principle, procuring only a portion of the capacity needed to reliably serve all load will likely be less effective or efficient than procuring all capacity needed to serve all load.

Procuring a subset risks inadvertently distorting competitive relationships between resource classes. If only a portion of required resources are receiving ‘supplemental’ compensation, other resources by design become less profitable. Assuming a portion of needed resources will continue to operate consistent with historical availability and reliability performance fails to recognize the continuous review and adjustments that are expected in competitive markets.

The Backstop Reliability Service would seem to have the advantage of fast(er) implementation, and may be best used as an interim measure in place until a more comprehensive Load-Side Reliability Mechanism can be developed. We suggest making it clear at the outset that this service is indeed an interim program, and set a sunset date.

We assume that any Backstop Reliability Service would be procured on a monthly or seasonal basis, definitely not as part of the day-ahead market clearing. Although the principle that Backstop reserves should be deployed so as to not reduce real-time energy prices is clear, a question remains regarding whether the Backstop reserves could provide other ancillary services or whether they would be completely withheld.

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Respectfully submitted,

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THE R STREET INSTITUTE EXECUTIVE SUMMARY:

1. Define an economically efficient reliability standard for any Load-Side Reliability Mechanism identified in the Road Map.
2. Procuring only a portion of the capacity needed to reliably serve all load will likely be less effective or efficient than procuring all capacity needed to serve all load. Reforms should ensure a level playing field among conventional and unconventional supply- and demand-side resources rather than introduce inadvertent discriminatory rules.
3. If implemented, a Backstop Reserve mechanism should be temporary from the outset.