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PROJECT NO. 52373

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

VISTRA CORP.'S COMMENTS IN RESPONSE TO STAFF'S DECEMBER 6, 2021 PHASE II MARKET DESIGN CONCEPTS AND PRINCIPLES MEMO

Vistra Corp. (Vistra), on behalf of its jurisdictional subsidiaries, files these comments in response to the Public Utility Commission of Texas (Commission) Staff's December 6, 2021 Memorandum in Project No. 52373 seeking comments on "Phase II" market design concepts and principles.[1] These comments are timely filed.[2]

I. COMMENTS

A. Vistra Supports a Robust Examination of Both a Load-Side Reliability Mechanism and a Backstop Reliability Service

The Commissioners have wisely stated their general desire to look more intently at the detailed principles and implementation methods for two general approaches: (1) a "Backstop Reliability Service" (BRS) that could be implemented relatively quickly; and (2) a "Load-Side Reliability Mechanism" that would take longer to develop and implement. Pursuing both is a good choice, and will enable the Commission, with the benefit of detailed study and stakeholder input, to thoroughly evaluate each option and analyze its impacts on reliability and on the market.

This evaluation is important. Today, ERCOT relies nearly exclusively on an energy market that risks reliable operations on the assumption that the receipt of marginal clearing prices for electric energy (plus volatile adders) is sufficient for resource owners to make rational long-term investment decisions. This crisis-based pricing model has failed to send sufficient long-term price signals for adequate dispatchable new-build. Real costs, such as the cost to procure firm gas transportation and storage, are not currently recoverable on the margin, which further undercuts reliability. The ERCOT market model's reliance on extreme volatility, the realities of ESG (environmental, social, and governance) pressures on financing, and the generators' challenges in

[1] Memorandum from Ben Haguewood to the Chairman, Commissioners, and Interested Parties (Dec. 6, 2021) ("Phase II Concepts Memo").

[2] *Id.* (setting deadline for comments on December 10, 2021).

securing resilient fuel at reasonable prices have discouraged and, absent change, will continue to discourage thermal dispatchable investment. While there is new investment in dispatchable batteries, they have limited duration and therefore limited reliability value for long-duration events such as Winter Storm Uri.

The existing system lacks an effective incentive to hedge costs and revenues in future years or otherwise minimize volatility by a locking in longer-term costs and revenues. Long term stability, not the promise of a single year's extreme gain, is what provides the certainty to make marginal units less likely to retire, incentivize investment in existing units to improve performance and reliability, and ultimately, provide a proper basis for new build. While the long-term solution is developed, a BRS approach could stabilize the current situation and be an integral part of the future. In the longer term, a well-designed load-side reliability mechanism, coupled with the Commission's Phase I improvements to the ORDC and other mechanisms, will be much more attractive to capital investment. BRS need not be limited only to a "bridge" to implementing a load-side reliability mechanism; BRS can co-exist with a such a mechanism, helping insure against low-probability/high-impact events (e.g., Winter Storm Uri) while a load-side reliability mechanism works to ensure sufficient capacity to meet projected typical net peak load needs.

Process-wise, it appears that the Commission has largely reached consensus regarding the BRS proposal, so to accelerate its development the Commission should direct ERCOT and stakeholders to begin evaluating implementation parameters while the Commission makes policy decisions (e.g., on penalties and cost allocation). The load-side reliability mechanism requires more discussion and decisions regarding framework, so the Commission may wish to sever that into a separate, focused project.

B. Vague Fears of "Market Power" Should Not Derail Full Consideration of a Load-Side Reliability Mechanism

The Commission's discussions of a load-side reliability mechanism have often included expressions of ambiguous fears that so-called "gentailers" will somehow be able to disrupt the normal forces of competition by engaging in unspecified "market power" abuse under such a construct. Any competitive market is potentially subject to adverse impacts from market power abuse if normal forces of competitive discipline are not brought to bear and regulatory oversight

fails to supplement. There is no evidence, however, nor any specific fact-based allegation, that a load-side reliability mechanism would present unique concerns.

In the ERCOT market today, load-serving entities (LSEs) have to procure energy, ancillary services, and renewable energy credits (RECs) to serve their customers. In the ERCOT market today, power generation companies with affiliated retail electric providers exist. And in the ERCOT market today, there have been no credible allegations or enforcement initiatives founded upon the notion that somehow those "gentailers" are preventing LSEs from obtaining sufficient market-priced energy, ancillary services, or RECs to serve their customers.[3] Accordingly, while it is always appropriate to ensure that competitive markets truly function competitively, there is no need to be fearful of a load-side reliability mechanism because of unspecific assertions that it might somehow be subject to "market power abuse."[4]

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[3] Regarding the expression of "market power" concerns, it is unclear how a bilateral open forward market that requires LSEs to procure reserves would be uncompetitive or raise unique or insurmountable market power concerns. As a forward product, it would be more like non-power commodities (e.g., oil, agricultural output, metals, etc.) than power. These commodities all trade economically in bilateral markets without concerns about market power abuse. Within the power sector, LSEs participate today in multiple competitive wholesale markets for energy and ancillary service, both through Commission regulated markets like the ERCOT day-ahead and real-time markets, as well as financially via bilateral transactions or on exchanges like the Intercontinental Exchange (ICE). In fact, ERCOT market participants regularly use a broad range of bilateral products without market power concerns arising. Over time, the market for the LSE obligation products should develop broadly, including participation in the broker markets and on exchanges. Each of these steps would further reduce any potential for market power abuse and could be accelerated through policy choices by the Commission.

It is possible that concerns raised about market power abuse actually reflect opposition to paying the costs required for reliability. Securing sufficient reserves to operate the grid reliably and resiliently will have costs, and regardless of the path forward, a competitive market will provide price discipline (as the Chair has noted, "the cure for high prices is high prices"), and Commission Staff and the Independent Market Monitor (IMM) are empowered to identify potential market power abuses if market forces are not working. Moreover, affiliated generation and retail operations are not inherently sources of market power abuse. While there are transactional cost advantages to such arrangements (e.g., credit efficiencies, avoiding the loss of bid-ask spread to a third-party exchange) and there is appeal to investors of common holding structures due to the earnings stability afforded by the partially offsetting earnings cycle of the wholesale and retail sectors, competitive markets should encourage economic efficiency, including in business forms. Additionally, each of the affiliated generation and retail entities are not monoliths—they are distinct competitive market players that can and often do buy and sell to and from unaffiliated third parties when it is in their economic interest to do so. That is only logical—for example, in a market structure that creates a value for energy or for capacity, or both, marginal pricing principles still apply, so if a generator can sell to a third party for more than its retail affiliate is willing to pay, then it should (and will) do so.

[4] Additionally, it is worth noting that the Staff memorandum's statement regarding mitigation of "market power" exertions by "electric generation companies that also serve retail customers" would, on its face, apply only to electric cooperatives and municipally owned utilities, each of which is subject to regulatory oversight by its governing body. *See* Phase II Concepts Memo at 4. Notably, under PURA, with respect to competitive entities (i.e., non-co-ops and non-munis), a power generation company cannot "serve retail customers" (see Tex. Util. Code § 31.002(10)) and a retail electric provider cannot be an "electric generation company" (see Tex. Util. Code § 31.002(17)), so the

C. A Combination of a Dispatchable Energy Credits Approach and Backstop Reliability Service Mechanism Would Undermine the Commission's Work To-Date

The Commission has already made decisions to proceed with several good market enhancements, which are described as the "Phase I" concepts in the Staff's Phase II Concept Memo. Those Phase I workstreams will be beneficial to the goal of encouraging additional investment, and preserving existing investment, in generation resources—especially dispatchable resources. And, importantly, those Phase I efforts will not distort the market with incentives aimed at a small subset of technologies or market players.

By contrast, a combination of a "Dispatchable Energy Credits" (DEC) model as the Commission has discussed along with a BRS would undermine the Phase I efforts by targeting incentives to only a narrow set of generation technologies or new market entrants, effectively penalizing the rest of the market's dispatchable capacity and undermining the already approved Phase I changes. The construct would have this negative effect, for example, by subsidizing entry into the market of inframarginal capacity that will depress LMPs and undermine the investment incentive of the ORDC changes. The DEC proposal would inject between 3,425 MW and 9,637 MW of subsidized capacity over the five years starting in 2023.[5] Even on the low end, this new capacity would effectively neutralize the modified ORDC's economic signal to non-subsidized generation by interfering with day-to-day market operations. Furthermore, the kind of efficient, fast-start, and fast-ramping capacity targeted by the DEC proposal should already have operational and cost advantages—sufficient to encourage investment in it—from real-time market opportunities and qualification for additional ancillary services, obviating the need for and wisdom of targeted subsidies for this capacity.

By giving incentives to that narrow group, the DEC+BRS approach would attract a select set of new MWs that would crowd out the existing MWs that would not receive such extra incentives and cause a chilling effect on any potential market-based investment, thus necessitating future subsidies and creating a systemically bifurcated market based on picking winners and losers—in effect it would be a death spiral for the competitive electricity markets. That approach

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memorandum's assertion is not consistent with the existing market design under PURA if it implies that there can be competitive "electric generation companies that also serve retail customers."

[5] *See* Eolian Comments at 14 (November 18, 2021).

would lessen resource adequacy and thus undermine the purposes behind the Phase I and Phase II efforts. BRS would not be a cure-all for that crowding out effect, as the DEC-induced MWs would simply drive out other dispatchable capacity, necessitating a larger BRS than would otherwise be indicated.

D. A Backstop Reliability Service Mechanism Must be Appropriately Sized to be Effective

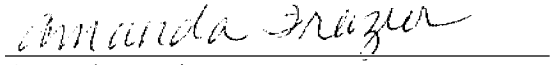
While the Staff's Phase II Concepts Memo does not state any criteria for determining the size of a BRS approach, the Commission should be cautious about imputing or implying that a BRS might encompass only a handful of thousand megawatts. To ensure sufficient resource adequacy and avoid a repeat of load shed like in Uri, the BRS generation must be reserved to achieve reliability insurance, and must be sized to provide real insurance in such adverse conditions. Over time and following development of the full set of market changes, the BRS reservation procurement targets should be adjusted to reflect the changing market, as appropriately addressed in the "dynamic" sizing principle stated in the Staff's Phase II Concept Memo.

II. CONCLUSION

Vistra appreciates the opportunity to provide these comments for the Commission's consideration as it works to improve the ERCOT market design by developing appropriate Phase II concepts and principles. Vistra looks forward to continued participation in this effort and encourages the Commission to continue to expressly seek and value intense, detailed, and continuous evaluation and input from the stakeholders, each of whom has directly and substantially invested in the long-term success of the Texas electric power market.

Dated December 10, 2021

Respectfully submitted,



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STAND-ALONE EXECUTIVE SUMMARY OF VISTRA CORP.'S COMMENTS IN RESPONSE TO STAFF'S DECEMBER 6, 2021 PHASE II CONCEPTS MEMO

- Vistra supports a robust examination of both a load-side reliability mechanism and a Backstop Reliability Service (BRS) approach.
    - The Commission should continue to expressly seek and value intense, detailed, and continuous evaluation and input from stakeholders, each of whom has directly and substantially invested in the long-term success of the Texas market.
- Vague fears of "market power" should not derail full consideration of a load-side reliability mechanism.
    - Such a construct does not raise significant or unique market power abuse concerns or provide unfair advantage to LSEs with competitive generation affiliates.
    - A load-side reliability mechanism would simply add a product, without raising new fundamental structural changes that would alter the competitive dynamic.
    - The Commission has ample tools to monitor and address potential market power abuses and could also adopt enhanced transparency measures if it has concerns.
- A load-side reliability mechanism will entail some cost to consumers, but those costs are necessary to provide significantly enhanced reliability.
- A combination of a Dispatchable Energy Credits (DEC) approach and a BRS mechanism would undermine the Commission's Phase I work.
    - It would undermine the Phase I efforts by targeting incentives to only a narrow set of generation technologies or new market entrants.
    - By giving incentives to that narrow group, the DEC+BRS approach would attract a select set of new MWs, crowding out existing non-subsidized MWs.
    - DEC + BRS would subsidize entry into the market of inframarginal capacity that will depress LMPs and undermine the investment incentive of the ORDC changes.
- A BRS approach should be sized to fully address the resource adequacy issue under unusual system circumstances.