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December 15, 2021

The Honorable Greg Abbott
Office of the Governor
PO Box 12428
Austin, Texas 78711-2428

Chairman Lake
Commissioner McAdams
Commissioner Cobos
Commissioner Glotfelty
Public Utility Commission of Texas
1701 N. Congress Avenue
PO Box 13326
Austin, TX 78711-3326

Dear Governor Abbott, Chairman Lake, and Commissioners,

We write in response to the letter dated December 13, 2021, from the Texas Association of Manufacturers (TAM) to you all regarding potential wholesale electricity market designs to ensure reliability and cost-effective electricity service in the ERCOT market.

It is important to correct some misconceptions in the above-referenced letter about the role and likely impacts of a key market design reform option considered in the PUC market design review project (Project 52373): the Load-Serving Entity Reliability Obligation (LSERO). Since the LSERO concept was introduced, commissioners have discussed it extensively, making modifications to create a uniquely Texas solution to a difficult problem. Further work remains to be done if the Commission continues to consider this concept as a plausible solution, which we hope they will do.

First, contrary to the assertion that “the Legislature considered several similar proposals last session and rejected them”, the plain language of SB3 supports the implementation of an LSE Obligation or something very similar to it. Specifically, Section 39.159 of SB3 directs the PUC to ensure ERCOT:

- “Establishes requirements to meet the reliability needs of the power region”,
- “Determines the quantity and characteristics of ancillary or reliability services necessary to ensure appropriate reliability during extreme heat and extreme cold weather conditions”, and
- “Develops appropriate qualification and performance requirements for providing [ancillary or reliability] services ... including financial penalties for failure to provide the services”.

The LSERO was proposed with these specific legislative requirements in mind. While some of the other market design proposals can contribute usefully to improving reliability in ERCOT, none of the other proposals establishes a comprehensive process that meets each of these requirements.

Second, TAM asserts that a resource adequacy requirement has “failed” or “has not improved reliability or changed investment trends” in other markets. Nothing could be further from the truth. While many aspects of our LSERO proposal are designed for ERCOT’s unique context, the concept of a resource adequacy obligation has been implemented *in every other U.S. competitive wholesale electricity market*, markets that serve a population of over 200 million. It has spurred the development of tens of thousands of megawatts of gas-fired generation capacity across the country and helped ensure reliable electricity service through severe heat waves and polar vortex weather events. ERCOT’s current market design relies on the *hope* that occasionally high real-time prices will provide the incentive for private investment in generation capacity, a signal that has been recently muted through a reduction in the high systemwide offer cap. The LSERO, by contrast, establishes a minimum standard of reliability and *requires* sufficient investment in power plants to meet this standard, providing a backstop role for ERCOT to remedy a systemwide deficiency through emergency procurement.

Third, TAM characterizes the LSERO as “shifting generator profits from a performance-based model to guaranteed payments” to generators for “just existing”. That statement is patently false. The *current* ERCOT market design does not *require* generator performance. The LSERO changes that. Our proposal puts an obligation on generators that sell reliability services to offer all their output into the market when called upon by ERCOT to do so, with strong financial penalties for non-performance. In fact, it is the only proposal to date that would obligate a sufficient amount of generation to be online, producing energy, to cover demand during these extreme events, which SB3 requires. Moreover, it provides for a “tough but fair” resource accreditation process that ensures Texas has the dispatchable generation capacity without overly crediting or relying on resources that do not contribute to system reliability.

Fourth, we would like to note that a key feature of the LSERO is that it entirely exempts customers, including many of the TAM membership, who can curtail their load or switch to backup generation at times of system stress. This is an important incentive to establish. Customers whose load can be conditionally curtailed would have that capability recognized through the resource accreditation process. There is no reason to require LSEs to forward-procure reliability services for customers who do not need them, but it is critical to ensure resources are available to provide reliability services for customers that do need them.

Finally, the LSERO proposal is not only consistent with the competitive market principles on which Texas’s electricity market is based, but essential to ensuring that the competitive market continues to operate efficiently. Reliability obligations are a feature of competitive electricity markets in every other state. The LSERO proposal follows sound competitive market principles by: (1) placing the compliance obligation on the load-serving entities rather than ERCOT or the utilities; (2) allowing those entities the freedom to develop their own competitive procurement strategies; (3) establishing an unbiased and non-discriminatory resource accreditation process that allows all resources to compete on an equal footing based on their ability to contribute to systemwide reliability – key to minimizing consumer costs; and (4) imposing strong financial penalties for non-performance.

We agree with Chairman Lake’s statements on December 1 that Texas should not “sacrifice reliability over fear of rising prices.” The Commission’s consultants at the Brattle Group have forecast an

approximately 7% price impact on electricity resulting from LSERO, in exchange for a system with more certain reliability, which will reduce the costs of power outages themselves. Thank you for your continued efforts to improve the reliability of the Texas electricity system.

Sincerely,


Arne Olson
Senior Partner

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Zach Ming
Director

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Beth Garza
Independent Consultant

