PUC PROJECT NO. 54335

REVIEW OF MARKET REFORM ASSESSMENT PRODUCED BY ENERGY AND ENVIRONMENTAL ECONOMICS, INC. (E3)	**§ § § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

COMMENTS OF THE TEXAS ENERGY BUYERS ALLIANCE

Introduction

The Texas Energy Buyers Alliance[1] (TEBA) represents the collective voice of more than 300 companies, representing some of the state's largest employers and energy customers. In total, TEBA members represent more than $7 trillion in annual revenues and more than 16 million US employees. Our organization is focused on helping to shape Texas' electricity market redesign in ways that propel Texas' economy forward, lower power bills for all energy customers, create jobs, spur innovation, strengthen the ERCOT grid, and extend Texas' energy leadership through the energy transition and for generations to come.

Many TEBA companies located their businesses in Texas in part because of its dependable business environment and open energy markets — including low-cost, increasingly clean, reliable power, and the ability to freely choose and procure it without unnecessary regulations or red tape. TEBA members believe reliable, clean, affordable energy is good for business, and that what's good for business is good for Texas.

TEBA's perspective on the market design questions arising from the E3 report can be summed up simply: Texas shouldn't make it difficult or expensive for customers to acquire whatever energy they want to support their business needs. Reliability, beyond the

[1] https://txenergybuyers.org

weatherization efforts already taken, can be met by focusing on paying for specific operational attributes that the independent system operator needs instead of paying for generalized capacity. The proposed Performance Credit Mechanism (PCM) has significant flaws in this regard and incentivizes unhelpful behavior from both buyers and sellers. If the Commission desires a market design that meets a target reserve margin, the most straightforward way to do so would be to structure the ORDC so that the expected revenue increases reserves to meet a targeted reserve margin and look to bolstered or new ancillary services.

TEBA respectfully submits the following responses to the questions posed by the Commission in its filing in this docket on November 15, 2022.

Comments

1. **The E3 report observes that the PCM has no prior precedent for implementation; does this fact present a significant obstacle to its operation for the ERCOT market?**

TEBA believes the lack of testing and validation of the PCM presents a significant obstacle to its operation for the ERCOT market. This concern is heightened by the potential for the PCM to damage particular classes of technology through the reduction of revenues for clean energy producers, which therefore increases costs to all energy customers, but especially clean energy buyers.

Instead, the Commission should apply tested procedures that treat all resources fairly. To the extent that there are operational concerns with the reliability of clean energy over a multi-hour period, Texas should procure excess capacity from longer duration facilities in a technology neutral way, such as through the daily and annual procurement of ancillary services. This tried-and-true approach ensures that Texans are paying for what they actually need instead of rewarding specific thermal generators if they happen to be online.

2. **Would the PCM design incentivize generation performance, retention, and market entry consistent with the Legislature's and the commission's goal to meet demand during times of net peak load and extreme power consumption conditions? Why or why not?**

No. The PCM doesn't reward generator performance, and can harm retention. Instead, the PCM creates the wrong incentives for generators by encouraging generators to run when they aren't needed to meet the online availability requirements necessary for financial compensation. Instead of rewarding generators when they are actually needed, it merely pays them based on when they are available during a set of hours determined by the Commission. Generators that try to run to be available during the proposed 30 hours in a year (or 4 or 6 hours in a month) will be forced to guess how to operate during hours *when they may not actually be needed for operations.* Generators that over-commit in this way will increase their own costs and wear and tear, increase emissions, and perhaps run during hours when the price of electricity is below their short run operational costs in the hopes that their losses will be made up for in the PCM payments. Even worse, if generators are forced to sell in advance, they **must** run during these hours or potentially pay substantial penalties for non-performance and replacing PCs that they sold but weren't able to produce.

While there may be enough money on the table for the generation investors to be willing to gamble for PCMs, there is a better way to get similar behavioral incentives without these bad outcomes: the existing energy market augmented with expanded or new ancillary services. Generators that are available stand to be very profitable, especially if they reduce their exposure to the spot price of natural gas. Ancillary services can pay for the specific operational needs ERCOT wants, which will guarantee they are available in the future. Conversely, generators that fail to provide energy that they sold in advance can suffer enormous losses. The Brazos bankruptcy is the largest example of this: Brazos failed to provide energy to meet its load obligation and was charged the replacement cost of that energy, which had to be provided by other generators.

TEBA members and other energy customers must determine, through their retail contracts, how to manage energy price exposure. This retail shopping activity helps to firm the wholesale market and wholesale operations at scale. The retail market is well-suited to manage these complex goals and incentives, provided the wholesale market is structured to properly price those risks and opportunities. This is best served in a simple fashion, such as through energy prices and ancillary services costs. On the contrary, a novel PCM would inject more uncertainty into retail markets and make it difficult for customers to efficiently manage costs.

If a PCM is adopted, the existing energy market should retain as much of the revenue as possible to maintain these incentives – especially considering the incentives created by the PCM to engage in uneconomic activity when there is no reliability need to do so. High energy market prices offer superior incentives and a far better lever to curtail activity – when the price of electricity *at the present time* exceeds the value of consuming it (the value of lost load) then consumers have a strong incentive to reduce operations without the need for government intervention.

When energy prices exceed the individual value of lost load for a specific customer, it is more economic for that customer to not consume electricity than to consume it. This is especially true if the customer bought power in advance, because they can sell it back to ERCOT at a higher profit than the value of the product they normally produce. The PCM, by contorting the real time energy price, blunts the incentive for economically efficient demand response, rather than enhancing it by suppressing the real time price. Therefore, if the PCM is created, the Commission should make every effort to minimize the amount of revenue within the PCM and maximize the amount of revenue in the existing energy market, in order to retain these strong incentives.

3. **What is the appropriate reliability standard to achieve the goals stated in Question 2? Is 1-in-10 loss of load expectation (LOLE) a reasonable standard to set, or should another standard be used, such as expected unserved energy (EUE). If recommending a different standard, at what level should the standard be set (e.g., how many MWh of EUE per year)?**

Setting a reliability standard for the sole purpose of designing a regulatory framework to meet that standard is a case of the ends justifying the means. Rather than set a particular reliability standard, Texas should create a variety of metrics to assist policymakers and the public in understanding the state of the ERCOT market.

However, to the extent that a metric must be used for a reliability standard to justify a capacity-like regulatory framework, the Commission should balance costs and benefits of the metric. A metric isn't something that can be done with scientific precision and necessarily includes numerous assumptions around investor behavior, future load growth, fuel costs, and customer activities. Whatever approach is chosen should default toward minimizing customer costs. Eliminating assumptions or reducing their impact will take time to get right – and lifting a metric off the shelf is inappropriate. The Commission should open a stakeholder process to explore various metrics in depth.

4. **The E3 report examines 30 hours of highest reliability risk over a year. Is 30 the appropriate number of hours for this purpose? Should the reliability risk focus on a different measure?**

The proposed 30-hour standard and other similar proposals (such as four hours in a month, twelve in a season, etc.) aren't measuring hours where reliability is at risk. Instead, these hours just show when an arbitrary metric is at a certain point. This approach thus encourages buyers and sellers to focus on the metric, not specific reliable operations. Reliability risk should instead be addressed through specific ancillary services designed to meet specific reliability risks, so that market participants are rewarded for actual needs and Texas is not in a "teaching to the test" situation with the electric market.

5. **Over what period should the hours of highest reliability risk be determined? A year, a season, a month, or some other interval? At what point in time should that determination be made?**

See above answer to question 4. In addition, the longer the period that the regulatory mechanism considers, the higher the credit risk in terms of future invoices. ERCOT must require sufficient collateral – from both buyers and sellers – so that market participants can pay future invoices or pay for future non-performance. These issues must be worked out in advance and not left for some future stakeholder process, because the credit issues could make the overall approach unworkable.

For example, if annual or monthly PCM invoices represent 25 percent of the overall market, and if the PCM market is several billion dollars annually, then market participants would have to post cash or letters of credit to guarantee that they can pay these future invoices. In the example of annual invoices, the amount of ERCOT collateral requirements will increase by billions of dollars, and a mid-year default could create significant exposure for the remaining market participants if there was insufficient collateral. Even in a monthly PCM settlement, hundreds of millions of dollars in additional collateral will be required. This increases the cost of doing business and decreases purchasing power throughout the year by preventing collateral from going toward more economically efficient uses.

6. **Would a voluntary forward market for generation offers and a mandatory residual settlement process for LSE procurement provide additional generation revenue sufficient to incentivize resource availability in a way that improves reliability?**

A forward market can increase reliability by facilitating forward contracting if the lack of forward contracting helps prevent the provision of a particular service. Known forward revenues are often helpful for investors when evaluating market fit or market opportunities. However, energy customers and sellers shouldn't be forced into mandatory forward "markets" – definitionally, a market is made up of *willing* buyers and sellers. If ERCOT were to sponsor a voluntary forward market for energy and ancillary services, it could contribute to increased investment, risk reduction, and price discovery. As a coalition of buyers, TEBA appreciates more opportunities to transact voluntarily.

7. **Does a centrally cleared market through ERCOT sufficiently mitigate the risk of market power abuse? Should additional tools be considered?**

Compared to the proposed LSE Obligation that forced bilateral contracting, a centrally cleared market is superior because the transactions can be reviewed by the independent market monitor. But central clearing alone isn't enough to mitigate the loss of market forces, especially if the proposed regulatory framework reduces competition by excluding some sellers. Before requiring participation in a centrally cleared mechanism, the PUCT should seek input on market power concerns and design mechanisms to guarantee that energy customers aren't subject to market power abuse. At minimum, this means updating voluntary mitigation plans. If a seller is necessary for the market to clear and for supply and demand to meet, then that seller has market power and is a pivotal supplier. If some types of capacity are significantly reduced in the regulatory construct or are not allowed to participate in the market, then those policies would further concentrate market power. Any generation supplier that is necessary for the market to clear must have specific rules in place to prevent them from raising prices through the exercise of market power. These rules must be developed *before or concurrently with* a decision to require a new regulatory construct for generator revenue – and can't be left to a future stakeholder process.

8. **If the commission adopts a market design with a multi-year implementation timeline, is there a need for a short-term "bridge" product or service, like the Backstop Reliability Service (BRS), to maintain system reliability equivalent to a 1-in-10 LOLE or another reliability standard? If so, what product or service should be considered?**

A bridge that is based on ancillary services, even a new ancillary service, can both buy time for additional deliberation and generate new investment. The Commission also could consider additional non-spin and ECRS policies, or create a new ancillary service such as the "uncertainty product" proposed by the IMM.

9. **If implementing a short-term design as a "bridge" delays the ultimate solution, should it be considered? Is there an alternative to a bridge solution that could be implemented immediately, using existing products, such as a long-term commitment to buy the additional 5,630 MW of Ancillary services necessary to achieve the 1-in-10 LOLE reliability standard?**

TEBA believes that the suggested PCM and other market design proposals in the E3 report need additional planning before they can be seriously considered. If a reliability issue exists today, it can be mitigated through additional ancillary services, demand-side solutions, and the projected growth of generation resources. Proposals such as the "uncertainty product" can reduce the overall cost of ancillary services by allowing for a variety of response types – not just those that can be committed in 30 minutes or 10 minutes. Ancillary services are a flexible mechanism that can increase or decrease based on actual operational needs, whereas the PCM is a more permanent structure that will, by design, by rigid. Since it is untested, this flexibility of ancillary services is a benefit.

10. **What is the impact of the PCM on consumer costs?**

The PCM will inflate consumer costs because it is designed to give more money to existing generators — that money will come from buyers. How much money consumers will pay is still uncertain. As referenced in Question 1, the PCM is a novel concept that has not been employed in any other wholesale market. Without any points of comparison to actual operation in other markets or additional analysis outside of the E3 report, it is difficult to know with any degree of certainty just how much the PCM will cost Texas consumers.

The PCM does encourage buyers to stop consuming electricity during the proposed hours that PCMs are paid or charged to avoid PCM costs. But this creates a real opportunity cost for individuals, employers and the economy as a whole — most will likely continue to use electricity despite the benefits of standing down, and those who don't will curtail the state's overall economic activity.

Texas, as business-friendly state, shouldn't create incentives to artificially slow the economy without a very good reason to do so. But in many of the hours in which a PCM would be in place, there would be no actual reliability-related need to reduce energy consumption. If a PCM is created, customers should be able to reduce or avoid the costs of the regulatory mechanism by *being willing* to curtail use when it is necessary, not forced to arbitrarily curtail when it isn't.

If the Commission proceeds with a PCM, it should create a voluntary curtailment program, where customers that choose to sign up can reduce or avoid PCM costs. This program should include sufficient notice requirements so that a wide variety of customers can participate – 30 minutes isn't enough time, in many cases. A notice period of multiple hours is preferable, because it would better allow the safe shut down of operations.

11. **What is the fastest and most efficient manner to build a "bridge" product or service, such as the BRS, in order to start sending market signals for investment in new and dispatchable generation, while a multi-year market design is implemented by ERCOT? Please provide specific steps**

Step 1: Increase the quantity of ancillary services currently procured by ERCOT.

Step 2: Increase the type of ancillary services procured by ERCOT to create services with more notice or longer duration.

These simple steps would spur a market design that creates reliability based on choice — it would not even need to be a bridge to something else. But they also would buy time to allow the Commission to carefully deliberate about other market design alternatives.

12. **In what ways could the Dispatchable Energy Credit (DEC) design be modified through quantity and resource eligibility requirements, e.g. new technology such as small modular nuclear reactors, in such a way that it incentivizes new and dispatchable generation?**

TEBA does not take a position on this question.

_*/s/ Bryn Baker*__
Bryn Baker
Senior Director, Policy and Markets
Texas Energy Buyers Alliance
https://txenergybuyers.org

Executive Summary

The Texas Energy Buyers Alliance (TEBA) represents more than 300 of the state's largest employers and energy customers. We support an electricity market structure that propels the economy, lowers power bills for all Texans, creates jobs, spurs innovation, strengthens the ERCOT grid, and extends Texas' energy leadership. We believe reliable, clean, affordable energy is good for business, and what's good for business is good for Texas.

We also believe Texas should not make it difficult or expensive for customers to flexibly acquire energy that supports their business needs. Unfortunately, the proposed Performance Credit Mechanism (PCM) does just that, creating perverse incentives for both buyers and sellers. The state should focus on the immediate problem – ensuring reliability in the most affordable way – by paying generators for performance when it is needed. Texas' energy challenges are operational, not capacity-driven, and the PCM will not solve them.

Specifically, our filing demonstrates that:

1. The solution should be consistent with SB 3, relying on the existing energy market, and augmenting it with expanded or new ancillary services.
2. In addition to being unproven and untested, the PCM creates unjust and unreasonable discrimination against certain energy resources – thereby increasing costs for all energy customers.
3. The PCM creates the wrong incentives for generators, encouraging them to run when they aren't needed, increasing costs on customers.
4. If a PCM advances, the Commission should open a stakeholder process that considers the details of a reliability standard and examines each of the various assumptions that go into producing one, and then choose one that creates the least cost for consumers.
5. To meet a target reserve margin, the Commission should structure the ORDC to drive higher revenues, prompting generation investment in a market-driven way.