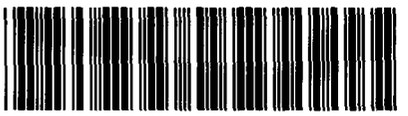

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**PROJECT NO. 47199**



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| **PROJECT TO ASSESS PRICE FORMATION RULES IN ERCOT'S ENERGY-ONLY MARKET** | § § § | **PUBLIC UTILITY COMMISSION OF TEXAS** |

## TEXAS INDUSTRIAL ENERGY CONSUMERS COMMENTS

Texas Industrial Energy Consumers (TIEC) submits this response to the Commission's August 18, 2017 request for parties to submit any "alternatives" to the proposals in Calpine and NRG's "*Priorities for the Evolution of the Energy Only Market.*"

## I. GENERAL COMMENTS

TIEC's members comprise the state's largest businesses and employers. As the Commission is aware, energy cost is a key factor in business decisions for these companies, and effectively managing electricity costs is a top priority. It is imperative for market rules be stable and predictable for businesses to successfully invest and grow in this state. To that end, TIEC generally opposes making significant market changes unless (1) a material shortcoming has been identified, and (2) a compelling case has been made that a change is cost-justified and consistent with the state's policy goals. Any proposed market change must be weighed against its costs, including ERCOT's implementation costs, the ongoing costs that market participants will bear under the proposed change, and the potential unintended consequences. For these reasons, TIEC believes that the commission should be discriminating and conservative in considering market changes. Continuously reexamining the market design creates uncertainty and instability, which can adversely impact both the wholesale market and overall economic activity.

As stated during the recent workshop, TIEC remains unclear as to the perceived problem that needs to be addressed by this project. The ERCOT market is performing exceptionally well. ERCOT has healthy reserves and an oversupply of capacity relative to the economically optimal level for the foreseeable future.[1] The market is also in a period of low natural gas prices and high renewable penetration. Given these conditions, stakeholders should not expect any material

[1] *See* May 2017 Capacity Demand and Reserves (CDR) Report (http://www.ercot.com/content/wcm/lists/114798/CapacityDemandandReserveReport-May2017.xlsx).



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scarcity pricing. Without a better understanding of the perceived problems, it is difficult at this time for TIEC to propose alternatives to NRG and Calpine's proposals.

Reading between the lines, NRG and Calpine's proposals appear to be primarily aimed at either (a) rewarding generators that are located in a load pocket, or (b) adjusting wholesale prices to offset the impact of subsidized renewable generation. As discussed below, TIEC does not believe that either of these is a legitimate objective. However, if the Commission believes that either load pockets or renewable development poses a significant problem, TIEC has potential alternative proposals that would (a) alleviate the presence of load pockets and, in turn, mitigate the need to use RMR or RUC to address local reliability, and (b) more appropriately assign costs to renewable generation to offset some of the market distortions created by federal subsidies.

## II. POTENTIAL ALTERNATIVE PROPOSALS

### A. Locational reliability issues are best prevented through a robust transmission grid that maximizes competition among generators.

Many of the proposals advanced by NRG and Calpine are aimed at increasing revenues to generators in the Houston region to the disadvantage of both customers in that area and generators outside of it. These proposals include pricing marginal losses and creating "locational" reserve requirements (i.e., local scarcity pricing). In large part, these proposals are premised on reducing Reliability Must Run (RMR) contracts or Reliability Unit Commitments (RUCs) by providing higher revenues to generators within a constrained area. However, that justification is misplaced. Local reliability issues develop when generation retirements or load growth occur at a faster rate than transmission can be constructed to allow other generators to serve loads in a particular area. If there is adequate ***system-wide capacity*** (which there is in ERCOT today), then the focus should be on preventing significant load pockets from developing in the first place through transmission planning, rather than attempting to forestall efficient unit retirements or impose pricing penalties for RUC. Focusing on facilitating competition through transmission development promotes overall resource adequacy by creating opportunities for more generators to serve load, instead of perpetuating local market power and high prices for customers in a constrained area.

The Commission should not endeavor to prevent appropriate unit retirements through artificial "local" scarcity pricing. A generation unit should retire when it is no longer economic

and is reaching the end of its useful life, regardless of where it is located. This is a natural cycle in a competitive market. Generator retirements rebalance supply and demand, and will naturally result in higher market revenues to encourage new build. However, when a significant generation unit retires, the transmission grid cannot be reconfigured overnight to offset the impact on power flows. For this reason, RMR will always be a necessary reliability backstop and should not be viewed as a "market failure" or the result of inadequate pricing signals. RMR contracts reflect a discrepancy in the timing of a generation retirement and the time it takes to update the transmission grid to account for the resulting impact on power flows. Rather than attempting to adjust prices to prevent efficient unit retirements, the Commission should focus on ensuring that there is sufficient transmission capacity for other generators to step into the shoes of a retiring unit and serve load without creating any reliability issues. Similarly, RUC commitments for local reliability typically occur because transmission constraints are preventing other, more economic units from being dispatched to serve load. A more robust transmission system will directionally reduce the need for uneconomic RUC commitments by allowing more generators to compete to provide electricity to load, reducing the need to rely on a handful of often inefficient generators that may have local market power.

The best way to cost-effectively prevent load pockets (and thereby reduce the need for RUC and RMR) is to build transmission when the costs of a project will be more than offset by a reduction in congestion costs for consumers. Congestion costs are an early indication of a load pocket because they occur when transmission lines are being overloaded and generators are being redispatched around a constraint (including RUC commitments). Once congestion costs are sufficiently high, it will be in consumers' interest to build transmission that will reduce those costs and, in turn, reduce the likelihood of a significant load pocket that might cause reliability issues later. As a result, economic transmission is a cost-effective effective way to ensure local reliability and preclude sustained congestion costs for consumers while minimizing the need for RUC or RMR.

Contrary to the arguments of some, inflating revenues for generators in a load pocket will ***not*** incentivize new generation or keep units from retiring. Dr. Patton acknowledged this at the recent Commission workshop. Generators will only build up to the point that the high prices will be preserved—which will not be sufficient to alleviate any localized reliability issues—and no one will build substantial new capacity based on prices that will disappear if new transmission is

built. Therefore, attempting to prop up uneconomic units in this manner is an imprudent use of customers' money and precludes efficient market turnover. Instead, the objective should be to allow as many generators to compete to serve load as possible through a robust but cost-effective transmission grid.

TIEC also observes that "locational" scarcity pricing proposals will have a disproportionate impact on populated, developed regions such as Houston. Institutionalizing high prices in populated or developed regions will have substantial adverse consequences for the state's economy. Large businesses located in regions that would be subject to "locational" scarcity pricing cannot pick up their plants and move them if the power prices are too high. It is inefficient and detrimental to the state's interests to encourage these businesses to reduce their economic activity in response to artificial "local" scarcity pricing when there is more than enough generation available within ERCOT. The legislature's decision to socialize transmission costs was guided, in part, by a desire not to create sustained high prices that would systematically disadvantage any particular economic region of the state. Locational scarcity pricing proposals that seek to institutionalize high prices for populated, economically developed regions are antithetical to that policy and should generally be disfavored. Dr. Patton's treatment of this issue at the workshop was illuminating, as he acknowledged that his preferred outcome could harm Texas businesses and the economy by discouraging consumption of electricity within certain areas of the state for the sake of economic theory. This is precisely the outcome that SB 7 and current Commission policies seek to avoid.

**B. Market distortions caused by renewable subsidies are better addressed by more accurately assigning costs to intermittent generation.**

The NRG and Calpine report also examines the impact that the Production Tax Credit (PTC) and zero-energy-cost renewable generation have had on power prices in ERCOT. Various proposals in the NRG and Calpine report are partially aimed at mitigating these impacts. TIEC agrees that federal subsidies have created undesirable market distortions. However, instead of materially changing the design of our energy market in ways that will have unintended adverse consequences for loads and other thermal generators, the Commission should consider whether intermittent generation should bear more responsibility for the costs that they impose on the system.

In particular, the Commission could examine whether it is appropriate to assign a share of ancillary services to generators that constitute "negative load" in ERCOT's planning models. ERCOT deals with intermittent resources in the exact same way as it does load—but in the opposite direction. That is why intermittent generation is often called "negative load." As a result, a case could be made for assigning ancillary service costs to both loads and "negative loads." This approach would more directly require intermittent generation to bear the costs it imposes on the system.

The Commission could also consider revisiting the appropriate transmission cost allocation for generators. While TIEC does not support participant funding as it has been used in other markets, TIEC ***does*** believe that it would be appropriate and prudent to impose an outer limit on the interconnection costs that can be assigned to customers for any particular generation development. As noted at the recent workshop, TIEC previously advocated for a transmission cost assignment process where generators would receive a pre-determined transmission cost allowance (on a per MW basis) toward their interconnection costs. Generators that need additional interconnection facilities or system upgrades would be required to cover any incremental costs above the transmission allowance. This approach would preserve the policy of funding generation interconnection costs to support the competitive wholesale market, but would reflect that certain unit siting decisions impose a disproportionate cost on the system. If the objective underlying marginal losses is to deter generators from locating remotely from loads, this type of interconnection allowance would accomplish that goal more directly and without unintended adverse consequences for customers in population centers or traditional generators that are outside population centers.

To the extent the Commission believes there is merit in attempting to counteract the market distortions that result from renewable subsidies, these proposals are a more direct and preferable way of achieving that purpose.

## III. CONCLUSION

TIEC values stability in the ERCOT's market, and urges the Commission to proceed cautiously and deliberately in pursuing any significant or costly market changes. The Commission should resist calls to endlessly "refine" and "enhance" ERCOT's successful market. Even minor changes can have unintended consequences and create uncertainty. The

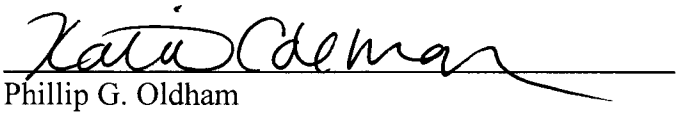
Commission should also avoid pursuing market changes based on abstract economic theory when this may have adverse consequences on market stability and the state's economic development objectives.

TIEC believes the market is working exceptionally well, and is not independently proposing any of the changes addressed in these comments. However, if the Commission desires to further reduce the need for RUC and RMR, TIEC submits that the transmission planning process should be modified to better protect against the creation of significant load pockets. To the extent that the Commission is concerned about price distortions caused by renewable subsidies, more accurately reflecting the costs that renewable generation imposes on the system is a better approach than adjusting energy prices in a way that will have broader impacts and unintended consequences.

TIEC looks forward to discussing these issues further at the upcoming workshop.

Respectfully submitted,

THOMPSON & KNIGHT LLP



Phillip G. Oldham
State Bar No. 00794392
Katherine L. Coleman
State Bar No. 24059596
Michael McMillin
State Bar No. 24088034
98 San Jacinto Blvd., Suite 1900
Austin, Texas 78701
(512) 469.6100
(512) 469.6180 (fax)

ATTORNEYS FOR TEXAS INDUSTRIAL ENERGY CONSUMERS