

Amend Texas Emergency Electric Rules To Protect Customers

By **Carolyn Berry** (May 17, 2021, 4:54 PM EDT)

The economic damage resulting from February's catastrophic winter storm in Texas is estimated to be in the tens of billions of dollars. To avoid this type of disaster in the future, market failures must be acknowledged, and legal and regulatory changes must be made.

One possible fix would be the adoption by the Electric Reliability Council of Texas, or ERCOT, of an alternative pricing mechanism in its real-time electric market during emergency periods. A well-structured emergency pricing mechanism could improve reliability, protect customers and restore confidence in ERCOT's energy-only market.



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ERCOT electric markets do not incentivize the provision of adequate electricity supplies during emergencies. This was shown in 2011 when, like this year, extremely cold weather resulted in blackouts.

Part of the reason for the lack of emergency supply is the laissez-faire nature of the Texas electric markets, where planning and oversight requirements are minimal. Another reason is the reliance on scarcity prices to elicit sufficient reliable supply. The Texas electricity market is an energy-only construct that relies on scarcity pricing — very high prices during hours of limited supply — to provide incentives for investment in generation resources and the provision of energy.

Unlike every other organized electricity market in the U.S., there is no mandatory generation capacity requirement in Texas. Scarcity pricing brings sufficient capacity to the market most of the time, but not during emergencies. Moreover, scarcity pricing during emergencies results in massive transfers of wealth from buyers to sellers.

In general, buyers are severely harmed by the inflated prices, and sellers receive a windfall profit due in large part to random factors such as location. Many buyers will not be willing or able to pay the enormous amounts that were charged for electricity during the recent winter storm. Bankruptcies and litigation stemming from this crisis will continue for years, and impose additional and significant costs on market participants.

Texas does not need to radically restructure its electricity markets to increase reliability, as was done in California after the energy crisis there. ERCOT could, however, implement special rules during emergencies that would provide badly needed protections for customers, and prevent the transfer of

vast amounts of wealth that does not, as expected, result in sufficient provision of reliable supply.

Modification of emergency pricing to address these challenges would include four elements: (1) a price cap in the range of \$500-\$1,000 per megawatt-hour; (2) a must-offer obligation; (3) an opportunity to recover natural gas costs; and (4) monetary incentives to reduce demand.

A price cap in the \$500-\$1,000 per MWh range is much lower than the current caps of \$9,000/MWh and \$2,000/MWh when the peaker net margin reaches a defined threshold. A lower price cap would reduce windfall transfers of wealth.

It would be more consistent with Texas anti-gouging laws under the Texas Deceptive Trade Practices Consumer Protection Act. A price cap in this range would also reduce the incentive for generators to withhold supply, since the amount that could be earned for remaining supply would be reduced.

The must-offer obligation would deter opportunistic behavior. This requirement is not punitive in electricity markets, as it could be in markets for goods, because energy cannot, for the most part, be stored. Exceptions to the must-offer obligation could be crafted for electricity storage. Offering all available supply during an emergency is consistent with the provision of a public good.

High natural gas prices may push the cost of gas-fired generation above the emergency price cap. No seller should be required to incur losses from providing electricity during an emergency. Producers should be guaranteed recovery of their costs.

The active involvement of the demand side of the market during emergencies is critical. Customers should be encouraged and given monetary incentives to consume less. A broad-based demand-side policy during emergencies should be crafted and implemented without delay.

There is little time left in the current Texas legislative session to vet issues and put in place changes to address the February crisis. The 87th Texas legislative session ends on May 31, and the next session does not begin until Jan. 10, 2023. The crafting and implementation of reforms must continue outside the legislative process.

Extreme weather events that will impact the energy sector are increasing in frequency. The changes needed to address this reality are best made through an inclusive broad-based process that could be pursued at the state regulatory level.

History has shown that the current rules in the Texas electric markets are insufficient to protect customers during emergencies. It is time to consider an alternative pricing mechanism during emergencies that protects customers, limits wealth transfers, and holds both suppliers and customers accountable.

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