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Sunset Advisory Commission
PO Box 13066
Austin, TX 78711

Re: Public Utility Commission Sunset Review

Dear Members of the Sunset Advisory Commission

The City of Houston (Houston) appreciates the opportunity to submit comments regarding the Sunset review of the Public Utility Commission of Texas (PUC) and the Electric Reliability Council of Texas (ERCOT). Houston's comments address issues related to (1) the PUC's and Electric Reliability Council of Texas's (ERCOT) plans to restructure the ERCOT wholesale power market, (2) concerns with adequately addressing problems that contributed to Winter Storm Uri outages, (3) generation acquisition and energy storage issues, (4) concerns with the PUC's trend of allowing more automatic rate adjustment provisions and effectively limiting municipal participation in regulatory proceedings, and (5) other utility regulation issues.

Houston exercises original jurisdiction over the rates, operations and services of investor-owned utilities — water/sewer, electric and natural gas — operating within Houston's jurisdiction. Houston's regulatory scope covers more than 1 million water and electric utility customers. As the regulator with original local jurisdiction, Houston is committed to fair and equitable rates for utility service, balancing the financial integrity of the utility with the integrity of the infrastructure and ensuring the health and safety of the public. To this end, Houston continues to work to improve, and to ensure the overall effectiveness, of water/sewer and electric utility rate regulation. The following comments represent this commitment.

COMMENTS

Much of the legislation passed in the aftermath of Winter Storm Uri addressed many needed changes in the regulation of the grid, including strengthening the authority of the PUC over ERCOT. Winter Strom Uri also highlighted the need for the PUC to be more active in addressing its responsibilities regarding the reliability of the ERCOT grid. Therefore, several of the issues that needed to be addressed since the prior Sunset Commission review of the PUC have been addressed by the Legislature or are being addressed by the PUC. Below are some of the issues and concerns that the City recommends for the Sunset Commission to consider in its review of the PUC.

1. **Distributed Energy Resource Storage facility costs.** In order to promote the installation of utility scale energy storage facilities, the Commission should provide that both transmission and distribution delivery costs for energy storage facilities be uplifted to the ERCOT market. Currently, only transmission costs are uplifted. Many utility-scale distributed energy resource storage ("DER-S") facilities are being installed in ERCOT. Some DER-S facilities interconnect on the utility's distribution

system rather than at transmission voltage. If the interconnection is at transmission voltage, the interconnection costs are not paid by the DER-S. Rather they are included in the utility's transmission cost of service (TCOS) and uplifted to the ERCOT market. However, if the DER-S is interconnected at a distribution voltage, the DER-S may pay a contribution in aid of construction (CIAC) and pays the utility's wholesale distribution service rate. DER-S facilities are considered similar to generation facilities when they discharge and sell energy into the ERCOT market. To be consistent, and to promote the use of new technologies such as DER-S, the PUC should treat DER-S connected at distribution voltage similar to those connected at transmission voltage.

2. Reporting of gas supply issues. The Commission should be required to include in its annual report to the Legislature a section that includes (1) a list of gas supply issues and policies that negatively impact the reliability of electric generation and (2) a description of proposed legislation that would fix each gas supply issue. This could cause the Railroad Commission (RRC) to take notice of action needed to fix the gas supply issues that impact electric generation. The RRC is not under Sunset Commission review until 2028.

3. Acquisition of generation located outside of Texas. Integrated utilities such as Entergy, own and acquire generation facilities in other states to serve customers in Texas. When acquiring generation facilities, utilities are required to file a certificate of convenience and necessity (CCN) application with the PUC per Public Utility Regulatory Act (PURA) §14.101. In its review, the Commission must consider whether the acquisition is in the public interest. PURA § 14.101(a)(1) states this public interest requirement is only required for a generation facility in Texas. Increased activity in acquiring renewable energy resources out of State allows utilities to avoid showing that the transaction is in the public interest. This section of PURA should be amended to require utilities to demonstrate that the acquisition of generation located outside of Texas are in the public interest.

4. Commissioners and staff experienced in investor-owned water utilities. The transfer of water utility regulation from TCEQ to the PUC has required the PUC to take on a new type of utility service that requires considerably more personnel and expertise with water and wastewater regulation. Further, many of the more seasoned PUC employees knowledgeable about water utility matters have left or retired. The PUC's budget needs to be increased to allow the agency to hire personnel to create a water utility division within the PUC that has dedicated personnel that understand water and sewer issues and primarily work on water utility matters. In addition, consideration should be given to the appointment of at least one Commissioner who has experience with investor-owned water utilities and their tariffs.

5. Number of rate adjustment riders. Investor-owned electric utilities (IOUs) have numerous rate adjustment riders that allow them to adjust rates for various high-dollar expenditures between rate cases. Examples are:

(a) Transmission Cost Recovery Factor (TCRF),
(b) Distribution Cost Recovery Factor (DCRF),
(c) Generation Cost Recovery Factor (GCRF) (non-ERCOT IOUs only),
(d) Interim TCOS rate adjustments, and
(e) Energy Efficiency Cost Recovery Factor (EECRF)

The proliferation of interim rate adjustment mechanisms and riders shifts the risk of poor expenditure decisions and potentially unreasonable investments to customers, rather than the utility and

its shareholders.[1] This may result in a disincentive to utilities to exercise prudence and caution in their capital investments. At least one Texas Utility has admitted that as much as 80% of funding for its capital expenditures is derived from interim rate adjustment mechanisms, which allow for quick rate recovery and rate increases to customers, before any regulatory authority even has the opportunity to review the appropriateness of the investment. The Legislature should consider reducing the number of rate adjustment riders or require a downward adjustment to an IOU's return on equity (ROE) to reflect the lower risk attributable to the riders.

6. Municipal rate case involvement. The Legislature should look at the manner in which the Commission responds to municipal rate case participation, including the limitations on discovery and hearing participation. The Commission requires municipalities to group together and divide issues, even though cities may have different issues and objectives. Utilities' rate case expenses, which have been considerably more than those of the cities, are not subject to the same level of scrutiny, even though both are usually paid by ratepayers.[2]

7. Commissioners as ex officio members of ERCOT Board. The PUC issued a 257-page Self-Evaluation Report to the Sunset Commission for consideration. Within that document, the PUC recommended that all five Commissioners[3] should be included as ex officio members of the ERCOT Board. If such an action also allowed all five Commissioners to have voting rights, this could give too much influence to the five ex officio members. The number of ex officio members that also have voting rights should be limited to one or two.

8. Load Serving Entity Obligation. The Commission, ERCOT and market participants are currently grappling with a re-design of the wholesale power market. Legislation may be needed to include specific requirements related to the ERCOT market design. For example, Chairman Lake continues to push for adding a Load Serving Entity (LSE) Obligation (i.e., a capacity market requirement) although several members of the House State Affairs Committee have challenged the need and cost for the LSE Obligation proposal. An LSE obligation will be costly to City of Houston consumers, yet it may not ensure the resilience and reliability of the ERCOT grid.

Market redesign issues which the City of Houston recommends that the Sunset Commission consider include:

1. The new market design must address the competitive market incentives necessary to ensure the adequacy of resources during grey and blue-sky events. Rather than mandating resource adequacy through an LSE obligation, the PUC and ERCOT should enhance the existing competitive energy-only market with new targeted ancillary services incenting new dispatchable resources to provide grid resilience and reliability as renewable resources continue to grow and play an even larger role. These dispatchable resources must be available and able to quickly respond to peak load emergencies (whether summer or winter) as well as responding to increasing ramping needs as wind and solar resource real-time MWh outputs quickly reduce with laying winds and waning sunlight.

2. The new market design must also address congestion cost and grid stability issues related to continued growth of inverter-based generation (wind, solar, and battery storage). Historically, ERCOT

[1] Some riders can result in rate adjustments that lower rates.
[2] In one previous rate case, Docket No. 49421, as part of a settlement CenterPoint agreed not to recover their rate case expenses.
[3] Currently, just the Chairman is an ex officio manager.

has been supplied by an overwhelming predominance of rotating synchronous generators which provide inertia stabilizing grid frequency during transient events (loss of large amounts of generation and line faults). The current market incentives in recent years are causing the retirement of large rotating synchronous generators and extensive growth of inverter-based generation. Large grid scale batteries may be able to provide grid stabilizing capabilities, however such is possibly ten years away. In the meantime, the ERCOT grid must rely on rotating synchronous generators to maintain stability.

3. The new market design should mitigate the influence of fuel supply and pricing on reliability, resilience, and retail customer affordability. The legislature should continue to assist the PUC and ERCOT by using its power and influence to ensure the reliability and resilience of natural gas supply and transmission during extreme weather events affecting the electric grid and during high electricity demand. The legislature should also provide for the monitoring, investigation, and enforcement of prohibitions on price gouging, physical withholding, and other manipulation by natural gas suppliers and marketers (especially during electricity scarcity events) hijacking "spark spreads" intended to incent new generation resources in ERCOT. Spark spread being the gross margin that a gas-fired power plant would derive from selling a MWh of electricity based on the amount and cost of fuel bought to produce the MWh of electricity. The generator must cover its other operation and maintenance, capital, and other financial costs derived from the collection of a spark spread.

4. The new market design should use competitive market fundamentals that enable all resource types (including load resources) to compete based on optimal services needed in the market that they can supply (i.e., technology agnostic). The attributes of these optimal services should include dispatchability, voltage support, fast ramping, firm fuel, emergency response, grid inertia and stability capabilities. The ERCOT market should incent and utilize all generation resource technologies necessary to provide reliable, resilient, sustainable, and affordable electricity service to its customers in Texas.

5. Over the past ten years, the ERCOT Independent Market Monitor ("IMM") has made a number of recommendations to improve ERCOT market performance for which no action has been taken to date by the PUC nor ERCOT. Below are several key provisions that the City of Houston recommends that the Sunset Commission consider:

- In 2019 the IMM recommended that ERCOT exclude fixed costs from the mitigated offer cap. To effectively mitigate market power, replacement real-time energy offers used by ERCOT (such as mitigated offers) should only include short-run marginal costs (i.e., the incremental costs incurred to produce additional output). Offering at prices higher than this level can only reduce a supplier's profits in a competitive market because the supplier will be displaced by lower-cost resources. However, this is not true when a supplier has market power and an increase in its offer price will raise the market prices and its profits as well as increase the cost to consumers in the City of Houston. Currently, the mitigated offer cap includes a multiplier that increases the offer price as the unit runs more. The operations and maintenance portion of verifiable costs already accounts for costs that increase as a unit runs more so the multiplier is not reasonable and not needed. The exceptional fuel costs calculation during mitigation also contains a multiplier that does not correspond to a resource's marginal costs when these multipliers are included. Allowing generators with market power to raise prices is an economically inefficient means to achieve fixed cost recovery, so these two multipliers should be removed to ensure that mitigated offer caps are set at competitive levels. This will help ensure that the market outcomes in ERCOT are

competitive and efficiently priced while allowing these resources to recover fixed costs in the same manner as all other resources.

- In 2021 the IMM recommended that ERCOT implement an uncertainty product. Following Winter Storm Uri, ERCOT regularly commits resources outside of the market through the Reliability Unit Commitment (RUC) process to ensure sufficient generation will be available to satisfy ERCOT's stated reliability margin of 6,500 MW of reserves plus an additional 1,000 MW of non-spinning reserve in uncertain hours. In addition, ERCOT has sought and obtained a change to the non-spinning reserve requirements to essentially make it a four-hour product (primarily impacting Energy Storage Resources). As the levels of renewable generation increase and ERCOT's conservative operations continue, these operational needs and out-of-market actions by ERCOT's operators and the associated uplift costs are likely to rise substantially (and be borne by City of Houston consumers). Thus, ERCOT should develop a Day Ahead Market capacity product to account for increasing uncertainty associated with intermittent generation output, load, and other factors. This would be a two- to four-hour ancillary service that could be deployed when uncertainty results in tight real-time conditions. Such a product should be co-optimized with the current energy and ancillary services products and could be deployed to bring online longer lead-time units when ERCOT detects operating conditions are departing from expected conditions.

- The markets should recognize and address this uncertainty, which can be accomplished by implementing a well-defined uncertainty product that ERCOT can deploy to meet these needs. This product would: 1) be less costly than holding excessive amounts of 30-minute reserves; 2) allow co-optimized product prices to reflect the value of managing uncertainty more fully; and 3) reduce out-of-market actions and the costs associated with those actions. In the longer term, once an uncertainty product is implemented, ERCOT can return non-spinning reserve and ERCOT Contingency Reserve Service (ECRS) to their previous duration requirements.

- Also in 2021, the IMM recommended that ERCOT re-evaluate net metering at certain sites. The City of Houston recommends that loads that can be turned on and off quickly, such as data centers and crypto mines, should, at a minimum, only be allowed net metering schemes among affiliated entities. This would help support price formation and provide better congestion management.

The City of Houston thanks you for your consideration of these comments.

Respectfully submitted,

DocuSigned by:
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