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Texas Court of Appeals Sets Aside Power Pricing Orders During Winter Storm Uri

By Craig R. Enochs, William W. Russell and Travis R. Reed*

In this article, the authors explain that, following a decision by a Texas appellate court, companies should consider evaluating the impact of potentially having to resettle transactions entered into at the price cap during Winter Storm Uri.

The Texas Court of Appeals at Austin has set aside the February 15 and 16, 2021, orders (the Orders) by the Public Utility Commission of Texas (PUC) that caused energy prices to be set at $9,000 per megawatt hour during Winter Storm Uri. The case was initiated on March 2, 2021, when Luminant Energy Company LLC – a market participant subject to the Electric Reliability Council of Texas (ERCOT) Nodal Protocols – filed a direct appeal challenging the Orders as competition rules under the Texas Public Utility Regulatory Act (PURA) Section 39.001(e). The court of appeals held that the Orders violated the statutory requirement that electricity prices be based on market competitive forces, not regulatory fiat. The court reversed the Orders and remanded the proceedings to the PUC.[1]

If the ruling is upheld, it could result in massive financial complications between counterparties. Companies should consider evaluating the impact of potentially having to resettle transactions entered into at the price cap during Winter Storm Uri.

BACKGROUND AND CONTEXT

PURA Context and Objectives

The court began its opinion by providing historic context for the Texas Public Utility Regulatory Act (PURA).[2] PURA was implemented as part of the federal government's and various states' efforts to reform the power industry in wake of the OPEC oil embargo and resultant energy crisis.[3] The objective was to foster competition in electric power markets via deregulation and restructuring.[4]

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1 Luminant Energy Co. LLC v. PUC of Tex., No. 03-21-00098-CV, 2023 Tex. App. LEXIS 1737 (Tex. App., 3d Dist. Austin Mar. 17, 2023, no pet. h.).

2 Tex. Util. Code Section 11.001 et seq.

3 Luminant, supra, at *5.

4 Id. at *5-6.

The Texas effort to deregulate began in 1999 with revisions to PURA.[5] A key aspect to Texas' deregulation was that "wholesale and retail rates generally be set by competition rather than regulation."[6] Since the expansive Texas power grid is entirely within the state, it is not subject to regulation by the Federal Energy Regulatory Commission.[7] The PUC has the regulatory jurisdiction over the market, and it established ERCOT as its Independent System Operator. ERCOT's responsibilities include ensuring "system reliability, nondiscriminatory access to transmission and distribution systems, and clearance of all market transactions in the region served by the grid."[8] Accordingly, "ERCOT acts as the central counterparty for all transactions it settles and is deemed to be the sole buyer to each seller (typically a generator), and the sole seller to each buyer (typically a retailer) of all energy and related services."[9]

PURA required the PUC to develop rules addressing scarcity pricing.[10] The PUC established a general Scarcity Pricing Mechanism (SPM) and directed ERCOT to develop and implement formulas and rules implementing the SPM.[11] Scarcity pricing has a system-wide offer cap of $9,000 per megawatt hour (MWh).[12] For context, the court noted that a typical market price is around $30/MWh.

The scarcity pricing mechanism had two goals: (1) "by offering windfall prices to peak generators through a number of scarcity price 'adders,' it creates incentives for any idle generation capacity to come online when demand (or 'load') threatens to exceed supply," and (2) "by imposing sticker-shock costs on consumption, it encourages conservation by any institutional consumers that may have some elasticity of demand, thus hopefully easing system load."[13]

Winter Storm Uri

In its opinion, the court of appeals provided insight into the weather phenomenon that led to Winter Storm Uri in February 2021, as well as various remarkable facts and statistics regarding the severity and impact of the storm.

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[5] Id. at *7.

[6] Id. (citing Tex. Util. Code Sections 39.001-.910).

[7] Id.

[8] Id. at *8.

[9] Id.

[10] Tex. Util. Code Section 39.151(d).

[11] Id. at *10 (citing ERCOT Nodal Protocols Section 6.5.7.3.1.).

[12] 16 Tex. Admin. Code Section 25.505(g)(6)(B).

[13] Id. at *11-12.

"When duration and precipitation are taken into account, Uri may have been the most severe winter weather event in the recorded history of Texas."[14]

As natural gas wellheads and gas lines began freezing during Uri, the gas supply for electric power generation went off-line. ERCOT must maintain a 60-hertz balance with generation on the grid, and the grid can suffer permanent damage if the grid dips below 59.4 Hertz for nine minutes. On February 15, the grid was below this level for over four minutes and was perilously close to total failure. In order to protect the grid, ERCOT repeatedly ordered increasing blackouts, also known as load shed. The storm had taken out 48.6 percent of the generation supplying the grid.

PUC February 15 and 16, 2021, Orders

During these first days of the storm, the pricing formula resulted in market prices of just over $1,200/MWh.[15] The PUC chair at the time, DeAnn Walker, determined that the SPM had malfunctioned because "the SPM was intended to move prices in an inverse correlation with reserve capacity and that, at load shed, maximum demand had by definition been reached, such that the maximum offer price should be in effect as well."[16] In the chair's opinion, the SPM erroneously disregarded the load shed in computing price. The PUC held meetings on February 15 and 16, 2021, where it issued the challenged Orders.[17] The February 15 Order stated that if "customer load is being shed, scarcity is at its maximum, and the market price for the energy needed to serve that load should also be at its highest." As directed, ERCOT adjusted its algorithms to implement the $9,000 price and issued settlement statements to market participants based on the revised pricing. On February 16, the PUC issued another Order to the same effect except that it rescinded language in the first order that would have required retroactive repricing.[18]

Luminant Direct Action in Austin Court of Appeals

Luminant and its aligned intervenors argued, generally, that the Orders were procedurally invalid and that the PUC did not have statutory authority to adopt them. In response, the PUC and its aligned intervenors contended that:

(1) The Orders were not rules;

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[14] Id. at *15.

[15] Id. at *19.

[16] Id. at *19-20.

[17] Id. at *13-14.

[18] Id. at 21-22.

(2) If they were rules, they were adopted in substantial compliance with emergency rulemaking provisions of the Administrative Procedure Act;

(3) The PUC was expressly authorized by statute to correct the allegedly erroneous pricing by the SPM; and

(4) The court lacked subject-matter jurisdiction.[19]

OPINION

The court issued its opinion on March 17, 2023. The court began by dismissing the PUC's five challenges to its jurisdiction. An in-depth analysis of these challenges is beyond the scope of this note, except for the following points of particular interest.

Jurisdiction

The PUC argued that the case was moot because the Orders and pricing only applied during the emergency circumstance during the storm. The court disagreed, finding that if the Orders are held to be invalid, then so too are the invoices based on the pricing they caused.[20] "The live controversy, then, is whether appellants are presently entitled to the difference between the invoiced prices and the much lower clearing prices that they argue would have been charged in the absence of the allegedly invalid Orders."[21] The court explained in further relevant reasoning that Luminant was challenging the settlement statements "through ERCOT's administrative [alternative dispute resolution (ADR)] process, alleging unlawful overpricing of thousands of dollars per megawatt hour; our decision in this appeal may have very real material consequences for all involved."[22] Similarly, when addressing the voidability argument, the court reasoned that the appellants "seek only a declaration as to the invalidity of the Orders, such that the pricing thereunder may not be applied in pending administrative proceedings."[23]

The PUC further argued that the court lacked jurisdiction over cases in which the alleged injury is not likely to be remedied by the requested relief.[24] In particular, the PUC argued that the court "cannot disturb transactions

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[19] Id. at *23.

[20] Id. at *24.

[21] Id.

[22] Id. at *25-26.

[23] Id. at *40.

[24] Id. at *44.

already settled, . . . [and] reversing the Orders will not result in the return of any money."[25]

Similar to the mootness argument, the court held that "we see no reason why the resolution of challenges to settlement invoices in ADR proceedings, whether due and payable or already paid under timely preserved protest, cannot and should not be governed by this Court's determination regarding appropriate pricing."[26]

The PUC also argued that in order for the court to have jurisdiction for this direct appeal, appellant must be contesting a competition "rule" within the meaning of PURA Section 39.001(e).[27] The PUC argued that the orders were not "rules" because they were not agency statements of general applicability, but rather they were mere statements regarding internal management or organization directed at ERCOT and not affecting private rights or procedures. The court rejected this position, stating that (1) the purpose and effect of the Orders was to cause market participants to pay or receive $9,000/MWh, and (2) ERCOT's actions as an agent are imputed to the principal, the PUC.[28]

Merits

Generally, appellants brought two challenges to the validity of the Orders: (1) that they constituted competition rules adopted in violation of the Administrative Procedure Act's rulemaking procedures, and (2) that they exceeded the PUC's statutory authority. The statutory authority argument has two components: (a) whether the Orders complied with the statutory requirement that electricity prices be determined by the normal forces of competition, and (b) whether the Orders were properly limited in duration. The court ultimately held that the Orders violated the statutory objective that prices be based on market forces, and therefore, it did not reach the other issues.[29]

The court cited PURA Section 39.001(a), which provides that "the production and sale of electricity is not a monopoly warranting regulation of rates, operations, and services and that the public interest in competitive electric markets requires that . . . electric services *and their prices should be determined by customer choices and the normal forces of competition*."[30] Further, "[r]egulatory authorities . . . shall *authorize or order competitive rather than regulatory methods*

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[25] Id.

[26] Id. at *45.

[27] Id. at *49.

[28] Id. at *51-56.

[29] Id. at *58-59.

[30] Id. at *60 (quoting Section 39.001(a)) (emphasis added).

to achieve the goals of this chapter to the greatest extent feasible and shall adopt rules and issue orders that are both practical and limited so as to *impose the least impact on competition*."[31]

The court held that the PUC acted outside its authority because the Orders removed competition from the price determination and replaced it with regulatory fiat during the storm:

> In extreme circumstances under extraordinary pressure, the Commission exceeded its power by eliminating competition entirely. . . . For four days under the Orders, the minimum price was the same as the maximum price by operation of executive fiat. . . . While the extraordinary circumstances of Winter Storm Uri may have required extraordinary modifications to the SPM . . . the Commission here exceeded the Legislature's limits on its power. Setting a single price at the rulebased maximum price violated the Legislature's requirement in the Utilities Code . . . that the Commission use competitive methods to the greatest extent feasible and impose the least impact on competition.[32]

The court reversed the Orders and remanded the case to the PUC for further proceedings consistent with the court's opinion.

LITIGATION FUTURE

Of course, the parties have appellate options before returning to the PUC. For example, the appellees could consider seeking a rehearing, an en banc reconsideration, and/or a petition for review with the Texas Supreme Court.

IMPACT ON MARKETS

The impact this ruling would have on markets, if upheld, is as significant as it is complicated. Assuming the market price should have been approximately $1,200/MWh over the four days the price cap was imposed would result in a massive amount of money owed between counterparties. Untangling the web of transactions would likely require difficult accounting analyses to sort out which parties owe refunds to others, and this is further complicated by several factors:

- Confidentiality provisions in relevant contracts between parties that may restrict the ability of a party to disclose transaction pricing information to the PUC or an auditor retained by the PUC;

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[31] Id. (quoting Section 39.001(d)) (emphasis added).

[32] Id. at *63-64.

- Some bilateral contracts may have limits on resettling prices between the parties that would restrict resettlement to periods of only a year or two after the relevant transaction expired, thus contractually protecting a party from being required to resettle with its counterparty; and
- Some entities, both those that would pay and receive refunds, have gone bankrupt and/or dissolved, and it is not clear how any shortfall or excess as a result of these parties missing from the market would be allocated in the market.

If this ruling is upheld, there will be a wave of uncertainty as to companies' potential liabilities or gains, and it may be prudent for companies to begin assessing their potential gain or loss if they are required to resettle transactions entered into at the price cap during Winter Storm Uri.