FIA.org

March 10, 2021

The Honorable Dade Phelan
Speaker
The Texas House of Representatives
P.O. Box 2910
Austin, TX 78768

Dear Speaker Phelan,

The Futures Industry Association ("FIA")[1] appreciates the opportunity to provide our members' views on the recent recommendation made by the Independent Market Monitor for the Public Utility Commission of Texas ("Commission") to direct the Electricity Reliability Council of Texas ("ERCOT") to retroactively alter real-time wholesale electricity pricing between February 18 and 19, 2021.[2]

First and foremost, we send our condolences to all those in Texas whose health and livelihoods have been adversely impacted by the February storm that brought unprecedented temperatures and ensuing power outages to the region.

We write regarding a narrow, but critically important, issue to our members: the inviolable nature of final settlement pricing in physical commodities and the related derivatives markets. In this case, we refer to the electric energy and ancillary service pricing in Texas as governed by ERCOT protocols that are used to financially settle certain futures contracts listed on national exchanges. Our members are very concerned by reports of the Commission and ERCOT receiving pressure to retroactively change and 're-price' the final energy and ancillary service prices set pursuant to ERCOT protocols. Such a retroactive re-pricing could have significant adverse consequences for the energy industry in Texas and ultimately Texas residents.

Many of our members participate directly in the ERCOT electricity markets or service customers who do. Our members and their customers also are active participants in the electricity futures markets such as those administered by ICE Futures US that settle to ERCOT energy and ancillary service prices ("ERCOT-linked futures contracts"). Our members participate as both counterparties to ERCOT-linked futures contracts to hedge risks, including price risk, attendant to their commercial energy operations in Texas and clearing members of ICE Futures US that provide access to ERCOT-linked futures contracts for other commercial hedgers.

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[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct.
[2] https://interchange.puc.texas.gov/Documents/51812_61_1114183.PDF

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Futures markets, including ERCOT-linked futures contracts at issue here, serve two core and inextricably related functions: price discovery and risk management. Commodity futures contracts are designed to track the price of the underlying physical commodity. Our industry refers to this as price convergence: the movement in the price of a futures contract toward the spot or cash price of the underlying commodity over time such that the price of the futures contract and spot price are roughly equal on the delivery date. Market participants rely on the price linkages between the underlying physical market and the futures market to manage and hedge the risk to their business that the price of the underlying commodity may move higher or lower at some time in the future. Futures markets can serve neither function—that of price discovery nor risk management—when there is not finality in pricing. Price certainty is an inviolable principle of markets.

In this case, market participants in Texas, including electricity suppliers, purchasers and service providers, entered into ERCOT-linked futures to hedge the risks they faced based on the prices published by ERCOT and visible to the marketplace. Altering those prices now would effectively leave those market participants unhedged as the price for the futures contracts they relied on to hedge their physical risks would become disconnected from the physical price.

There are also potential long-term consequences to Texas residents. Repricing now would call into question the integrity and continued viability of the electricity and related futures markets in Texas. FIA members and other market participants would have no incentive to participate in ERCOT and ERCOT-linked futures markets if they cannot be certain that the pricing mechanisms in those markets will be respected.

This is an extremely challenging time for the state and its residents. As you work to address concerns related to ERCOT and the February storm, we urge you to respect the inviolable role that pricing and finality of settlement plays in markets. A market without finality of price is no market at all. If the ERCOT energy and ancillary service prices are retroactively reset, market participants may observe this precedent and have no choice but to substantially curtail or even exit their activities in the Texas electricity markets. Ultimately, Texas residents and businesses could stand to be most impacted, as electricity prices could rise in the absence of reliable risk management mechanisms for electricity providers.

Thank you for your consideration of our position. If you have any questions about FIA or any points discussed herein, please contact Jacqueline Mesa, Chief Operating Officer and Senior Vice President, Global Policy, FIA, at jmesa@fia.org or 202-466-5460. We would be happy to discuss further the important role that our members and futures markets play in facilitating price discovery and risk management in the ERCOT marketplace.

Most respectfully,

Walt L. Lukken

Walt L. Lukken
President and CEO