NO. 23-0231

IN THE SUPREME COURT OF TEXAS

PUBLIC UTLITY COMMISSION OF TEXAS,
Petitioner,

v.

LUMINANT ENERGY COMPANY LLC,
Respondent.

FROM THE COURT OF APPEALS FOR THE
THIRD DISTRICT OF TEXAS AT AUSTIN

AMICUS CURIAE BRIEF OF THE FUTURES INDUSTRY ASSOCIATION INC.

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Table of Contents

Page

Index of Authorities

TO THE HONORABLE SUPREME COURT OF TEXAS:

The Futures Industry Association ("FIA") respectfully submits this *Amicus Curiae* Brief in support of the Petition for Review of Petitioner Public Utility Commission of Texas (the "Commission").

I. Interests of the Amicus Curiae

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.[1] FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 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.

Granting the Petition and reversing the decision of the Texas Court of Appeals, Third District ("Third Court"), are critically important to preserve: (1) the finality of the settlement prices of Electric Reliability Council of Texas ("ERCOT") wholesale electricity contracts; (2) the price risk management function of listed and over-the-counter ("OTC") derivatives contracts linked to the prices of

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[1] As required by Rule 11(c) of the Texas Rules of Appellate Procedure, FIA discloses that all fees for the preparation of this brief will be paid solely by FIA.

ERCOT electricity contracts; and (3) the confidence of market participants in the integrity and viability of Texas energy markets.

II. Statement of the Case

The suit filed by Respondent Luminant Energy Company LLC sought judicial review on direct appeal of two orders issued by the Commission on February 15 and 16, 2021, during Winter Storm Uri ("the Orders").[2] On March 17, 2023, the Texas Court of Appeals, Third District, issued an opinion in which it held that, by "[s]etting a single price at the rules-based maximum price," the Commission's Orders violated the requirement in Texas Utilities Code Section 39.001(d) that the Commission use competitive methods to the greatest extent feasible and impose the least impact on competition. *Luminant Energy Co. LLC v. Pub. Util. Comm'n of Tex.*, __ S.W.3d __, No. 03-21-00098-CV, 2023 WL 2546961, at *18 (Tex. App.—Austin Mar. 17, 2023, *pet. filed*). (App. C ("Third Court Decision")). The Third Court remanded the case for further proceedings consistent with its ruling. *Id*. The Third Court Decision did not address the substantial adverse impact it will have on final settlement prices in the Texas wholesale electricity market and the ability of market participants to use the derivatives markets to manage their exposure to changing electricity prices.

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[2] See App. A (Order Directing ERCOT to Take Action and Granting Exception to Commission Rules (Feb. 15, 2021)) ("First Order"); and App. B (Second Order Directing ERCOT to Take Action and Granting Exception to Commission Rules (Feb. 16, 2021)).

III. Statement of Jurisdiction

The Court has jurisdiction under Texas Government Code section 22.001(a).

IV. Statement Regarding Oral Argument

FIA does not request an opportunity to present oral argument.

V. Issues Presented

In addition to the issues presented by Petitioner, the issues presented are whether the Third Court's Decision will:

(1) undermine the finality of settlement prices of ERCOT wholesale electricity contracts;

(2) sever the critically important link between the prices of ERCOT electricity contracts and the prices of related listed and OTC derivatives contracts that market participants rely upon to manage their exposure to changing electricity prices;

(3) negatively affect the confidence of market participants in Texas energy markets; and

(4) increase energy costs for Texas businesses and citizens.

VI. Statement of Facts

For the convenience of the Court, FIA generally adopts the description in the Petition of the Commission's authority, the operation of the ERCOT market and settlement process, the Commission's Orders and market participant challenges to the Orders.

Winter Storm Uri inflicted tremendous hardships on Texas citizens. It caused an unprecedented increase in the demand for electricity and, at the same time, a precipitous decrease in the supplies of electricity and natural gas needed to generate electricity.[3] In an attempt to bring the supply and demand of electricity into equilibrium and to maintain the integrity of the electric grid, ERCOT issued several Energy Emergency Alerts ("EEAs") and ordered the load shed of electricity, essentially cutting of the supply of electricity to substantial portions of the State.

The ERCOT scarcity pricing mechanism ("SPM"), which was in effect during the morning of February 15, 2021, was designed to increase prices in order to increase supply and decrease demand for electricity. *Luminant*, 2023 WL 2546961, at *6. During the afternoon on February 15, the Commission concluded that the ERCOT SPM algorithm had malfunctioned because it failed to take into account the full scope of actual demand by disregarding demand that had been cut off from receiving electricity in order to maintain the integrity of the grid (*i.e.*,

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[3] Winter Storm Uri created "extreme cold combined with heavy precipitation" resulting in what "may have been the most severe winter weather event in the recorded history of Texas." *Luminant*, 2023 WL 2546961 at *4. Although Texas typically experiences peak electricity demand in the summer, Winter Storm Uri resulted in electricity demand that exceeded "even the highest summer demand on record." *Id.* at *5. The unprecedented demand occurred during substantial curtailments in supply because the extreme cold weather "froze poorly winterized natural gas wellheads and gathering lines, nearly halving the supply of the state's predominant fuel for electric generation at a time when the gas was already in high demand for direct-burn home heating in many areas." *Id.* The lack of fuel supply resulted in generation units going offline, which "overwhelmed ERCOT's ability to manage scarcity and began to threaten the stability of the grid itself." *Id*.

disregarding shed load). *Id*. After discovering the apparent malfunction, the Commission directed ERCOT "to ensure that firm load that is being shed in EEA3 is accounted for in ERCOT's scarcity pricing signals." First Order at 2. The Commission also directed ERCOT "to correct any past prices" to reflect load shed in scarcity price signals. *Id*. In addition, the Commission ordered ERCOT to "suspend any use of the [Low System-Wide Offer Cap]" until its next regularly scheduled meeting. *Id*.

As a result of the Commission's first Order, ERCOT adjusted its price algorithm to the "High System-Wide Offer Cap" (HCAP), which is administratively set at $9,000 per MWh.[4] On February 16, 2021, the Commission issued a second Order, which was substantially the same as the first Order except that it rescinded the requirement that ERCOT adjust prices retroactively. Thereafter, ERCOT "issued settlement statements to market participants reflecting the $9,000/MWh clearing price." *Luminant*, 2023 WL 2546961, at *6.

VII. Summary of Argument

FIA, on behalf of its members, advocates for competitive markets predicated on price certainty and enforceable contracts. To be clear, FIA is advocating for certainty of final settlement prices, not for any particular prices. The Third Court

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[4] ERCOT, M-C021521-01 Emergency Order of the Public Utility Commission Affecting ERCOT Market Prices (Feb. 15, 2021), http://www.ercot.com/services/comm/mkt_notices/archives/5196.

Decision, unless reversed by the Court, will impair the price certainty and enforceability of contracts that enable energy and derivatives markets to facilitate the efficient delivery of electricity and other energy commodities to Texas businesses and residential customers, particularly during times of market stress.

The natural consequence of the Third Court's reversal of the Commission's Orders will be to undermine the price finality of wholesale electricity contracts that were settled by ERCOT more than two years ago. If the Third Court's decision stands, the Commission may be constrained to require ERCOT to re-run wholesale energy market prices for all or a portion of the period when the Orders were in effect. While this may seem plausible in abstract theory, it is impossible retroactively to adjust prices to accurately reflect electricity supply and demand as they hypothetically might have existed in an earlier time-period.

Furthermore, the Third Court's decision will sever the critically important link between ERCOT wholesale electricity contracts and derivatives contracts that settled in February 2021 based upon ERCOT day-ahead and real-time electricity prices. Texas energy market participants relied upon those derivatives contracts to manage their exposure to changing electricity prices. Retroactive adjustment of ERCOT wholesale electricity prices likely would create a multi-billion-dollar mismatch between market participants' physical market gains or losses and their hedge position gains or losses. The practical effect of the Third Court Decision would be to create arbitrary, after-the-fact winners and losers in the Texas energy market.

Finally, if energy market participants lose confidence in the finality of ERCOT wholesale electricity prices, they may conclude that the increased risk of doing business in Texas requires them to raise prices or move their business elsewhere. That is likely to reduce electricity and fuel supplies, make the ERCOT market less efficient, and increase energy prices for Texas businesses and citizens.

VIII. Argument

Many of FIA's members are active participants in the Texas wholesale electricity and natural gas markets, and related derivatives markets. FIA's primary members are clearing members of futures exchanges and provide clearing services to companies that purchase and sell futures contracts linked to prices in the Texas electricity and natural gas markets. FIA's membership also includes futures exchanges, clearing organizations, and commercial commodity market participants.

Price certainty and enforceable contracts are critically important to the efficient supply of fuel and continuous production and delivery of electricity from generation facilities, through the ERCOT market, to commercial, industrial and retail customers in Texas. Commercial energy market participants are not guaranteed recovery of their costs or a rate of return on their investments. To achieve predictability of revenue, meet their financial commitments to creditors and investors, and ensure sustained reinvestment in the infrastructure necessary to operate their businesses, market participants must be able to trust that the settlement prices of their transactions in the ERCOT market are final other than to correct data, hardware or software-related errors within two Business Days, or absent notice within 30 days, of the relevant Operating Day.[5]

FIA members and their customers rely on the futures markets to discover prices and to manage the price risks associated with their commercial energy operations in Texas. Several futures exchanges, including ICE Futures U.S., NYMEX and Nodal Exchange, list futures contracts that settle against the ERCOT-published day-ahead and real-time locational marginal price ("LMP") of electricity at various price hubs and delivery points.[6] ICE Futures U.S. also lists natural gas futures contracts that settle against natural gas prices at, or linked to, delivery

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[5] Although Section 9.5.6 of the ERCOT Protocols provides the ERCOT Board with discretion to direct ERCOT to run a resettlement of Real-Time Energy Prices on an Operating Day in limited circumstances, it cannot do so unless ERCOT first issues a notice identifying a need for any price correction within 30 days of the relevant Operating Day. Memorandum from ERCOT Legal Department to ERCOT Board of Directors (Apr. 8, 2021), https://www.ercot.com/files/docs/2021/04/08/9_ERCOT_Legal_Memo_re_Board_Authority_to_Correct_Market_Prices_for_OD_02_18_19_2021.pdf.

[6] The ICE Futures U.S. listed electricity derivative contracts are available at https://www.theice.com/products/Futures-Options/Energy/Electricity. The NYMEX listed electricity derivative contracts are available at https://www.cmegroup.com/markets/products.html#assetClass=sg-11&sortField=oi. The Nodal Exchange listed electricity derivative contracts are available at https://www.nodalexchange.com/files/autogenerated/NEX_CONTRACT_INFO.zip.

points in Texas.[7] In addition to futures contracts, FIA members enter into swaps linked to ERCOT electricity prices and natural gas indices at Texas delivery points with Texas energy market participants to help them manage the risk of changing electricity and natural gas prices.

Futures contracts are designed to track the price of the underlying physical commodity. The futures industry refers to this as price convergence: the movement of the price of a futures contract toward the spot price of the underlying commodity over time so that the price of the futures contract and spot price are roughly equal on the futures contract final settlement date. In the case of cash-settled futures contracts, like those that settle against the average of ERCOT-published peak or off-peak real-time or day-ahead LMPs, the daily settlement price of a futures contract exactly tracks the average of the underlying referenced ERCOT electricity price. Market participants rely on this price linkage between the underlying physical market and the futures market to manage the risk to their businesses that the price of the underlying commodity may move higher or lower at some time in the future.

The U.S. Commodity Futures Trading Commission ("CFTC") requires futures exchanges to carefully consider whether a settlement price index is "a

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[7] The ICE Futures U.S. listed natural gas derivative contracts are available at https://www.theice.com/products/Futures-Options/Energy/Natural-Gas.

reliable indicator of market values and conditions."[8] In this regard, the CFTC has explained that "[t]he utility of a cash-settled [futures] contract for risk management and price discovery would be significantly impaired if the cash settlement price is not a reliable or robust indicator of the value of the underlying commodity. . . ."[9] Futures markets cannot serve their core functions of price discovery and risk management unless the prices of a referenced index are final.

The convergence of spot and futures prices enables market participants to hedge their price risk. For example, a Texas power plant owner that produces and sells electricity faces exposure to decreasing electricity prices. The power plant owner can hedge its physical commodity price risk by selling a futures contract or swap at a fixed LMP (*i.e.*, a short position). The short hedge position would increase in value as the price of electricity decreases, but would decrease in value if the price of electricity increases.[10] The power plant's short futures or swap position is designed to offset a loss in revenue from the physical sale of power if electricity prices decrease. Similarly, a commercial or retail electricity provider that must purchase electricity to fulfill its sales obligations faces exposure to

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[8] Appendix C to Part 38 of the CFTC's Regulations, Subparagraph (c)(2).

[9] *Id*.

[10] For example, if the day-ahead LMP decreases by $10/MWh, the power plant owner would lose that amount in the physical market, but the value of its short hedge position would increase by that same amount. Conversely, if the day-ahead LMP increases by $10/MWh, the power plant owner would gain that amount in the physical market, but the value of its short hedge position would decrease by that same amount.

increasing electricity prices. The electricity provider can hedge against the risk of increasing electricity prices by buying a futures contract or swap at a fixed LMP (*i.e.*, a long position). The long hedge position would increase in value as the price of electricity increases, but would decrease in value if the price of electricity decreases.

In a market with settlement price finality, prices in the futures and physical markets should converge, and a market participant's physical market gains or losses should approximately equal its futures or swap contract gains or losses. The ability to manage price risk using listed and OTC derivatives provides Texas energy businesses with the predictability they need to deliver electricity to Texas retail, commercial and industrial customers.

If the Third Court's Decision is not reversed, it will have many wide-ranging adverse and unpredictable consequences on the Texas energy market. For example, if the Commission's Orders are invalidated, it may be forced to require ERCOT retroactively to adjust wholesale electricity prices during all or part of the period when the Orders were in effect. It is not possible for a number of reasons to do this accurately. ERCOT cannot determine after-the-fact how energy market participants would have reacted to different electricity price signals more than two years ago. Moreover, there would be no retroactive adjustment of natural gas prices—the principal fuel for the generation of electricity—for the same period.

ERCOT simply cannot determine after-the-fact what the supply and demand for electricity would have been in that earlier period. Moreover, there is no sound basis for presuming that retroactively adjusted prices would be lower than $9,000.00/MWh.[11]

Furthermore, if the Commission is forced to require ERCOT to adjust electricity prices retroactively, it will sever the price linkage between the cash and derivatives markets. There is no clear legal or practical way, more than two years after-the-fact, retroactively to adjust the prices of ERCOT-linked futures contracts and OTC swaps.[12] If, in contrast to the settlement price finality of derivatives contracts, wholesale electricity prices are adjusted retroactively, market participants' gains or losses on their physical market positions no longer will approximate their gains or losses on their derivatives market positions. Instead of

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[11] The alternative to the ERCOT ordered HCAP price was the "Low System-Wide Offer Cap" ("LCAP") price, which would have been the greater of either (1) $2,000 per MWh; or (2) 50 times the natural gas price index value determined by ERCOT. Based upon a study by the University of Texas, the high demand for and low supply of natural gas during Winter Storm Uri caused an increase in the price for natural gas, which in turn increased the LCAP. If the Commission had not directed ERCOT to suspend the LCAP in its February 15, 2021 Order, the price of electricity on February 18, 2021, potentially would have been $15,359/MWh, far in excess of the HCAP of $9,000/MWh. University of Texas at Austin Energy Institute, *Events of the February 2021 Texas Electric Grid Blackouts,* at 62-63 (July 2021), https://www.puc.texas.gov/agency/resources/reports/utaustin_(2021)_eventsfebruary2021texasblackout_(002)final_07_12_21.pdf. Consequently, total energy costs for the week of February 15, 2021, could have been approximately $5.2 billion higher absent the Commission's Orders. *Id*. at 64.

[12] *See, e.g.*, ICE Futures U.S. Trading Rule 4.34(d)(A), https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf (Limiting the circumstances in which the exchange can correct settlement price errors); CME Group Rule 812, https://www.cmegroup.com/rulebook/CME/ (Payments on finally settled futures contracts cannot be adjusted after ten business days for any reason, even if there is a calculation error or erroneous input).

having a gain in the physical market and an equivalent loss in the derivatives market (or *vice versa*), many market participants very well could have a loss in both markets. Other market participants may have the windfall of gains in both markets. Such an imbalance would impair the ability of market participants to hedge physical market price risk using the futures markets. A retroactive adjustment of ERCOT prices more than two years after they originally were final would erode confidence in ERCOT prices generally, which in turn would undermine the ability of exchanges and market participants to utilize ERCOT prices as reference prices for listed or OTC derivatives contracts.

Furthermore, even if it were possible retroactively to adjust futures and swap prices retroactively, there is no mechanism for clawing back settlement payments many years after they occur. In the futures market, once a futures contract position settles, the exchange clearinghouse pays to or collects from (depending upon whether there is a gain or loss on the settled contract) a clearing member which, in turn, does the same with its customer. Those settlement payments effectively are irrevocable and unconditional once the relevant accounts are debited or credited.[13]

[13] The CFTC requires clearinghouses to ensure that all settlements of futures contracts are final except to correct errors. *See* CFTC Regulation 39.14(d), 17 C.F.R. § 39.14(d) ("A derivatives clearing organization *shall ensure that settlements are final when effected* by ensuring that it has entered into legal agreements that state that *settlement fund transfers are irrevocable and unconditional* no later than when the derivatives clearing organization's accounts are debited or credited; provided, however, a derivatives clearing organization's legal agreements with its settlement banks may provide for the correction of errors." (emphasis added)).

Similarly, an OTC swap typically settles monthly during its term through a net payment by one party to the other. Neither futures clearing agreements nor common industry practice with regard to bilaterally-negotiated swap agreements include a right for one party to demand repayment of settlement payments many years after final settlement.

Commercial businesses cannot manage their costs and protect their expected revenue in a market where physical energy contract and derivatives contract prices are disconnected. Repricing ERCOT electricity contract prices many years after-the-fact would adversely affect Texas businesses and residents by calling into question the integrity and continued viability of the ERCOT electricity market. FIA members and other market participants would have less incentive to continue to participate in the ERCOT electricity market and ERCOT price-linked futures markets if they cannot be certain that the pricing mechanism in the ERCOT market will be respected. And, if they elect to continue to participate in the Texas energy market, they may charge a premium in an effort to manage the increased risk of future repricing events.

The Commission's Orders and ERCOT's actions in compliance with those Orders were designed to increase the supply of electricity to Texas residential, commercial, and industrial customers in a highly stressed market. Absent the Commission's Orders and ERCOT's response, Texas customers might have faced prolonged outages due to inadequate supply. The Court should reverse the Third Court Decision to preserve the finality of ERCOT settlement prices and the critical link between those prices and the prices of listed and OTC derivatives that Texas energy market participants rely upon to manage their exposure to changing electricity prices.

Prayer

For the foregoing reasons, FIA respectfully requests that the Court grant Petitioner's Petition for Review and reverse the Third Court's Decision.

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May 17, 2023

CERTIFICATE OF COMPLIANCE

I certify that this Brief complies with the typeface requirements of Tex. R. App. P. 9.4(e) because it has been prepared in a conventional typeface no smaller than 14-point for text and 12-point for footnotes. This document also complies with the word-count limitations of Tex. R. App. P. 9.4(i)(2)(B) because it contains 3,497 words, excluding the parts of the brief exempted by Tex. R. App. P. 9.4(i)(1).

/s/ Paul J. Pantano, Jr.
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of foregoing has been served via e-file upon all counsel of record on May 17, 2023.

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