

## BUSINESS

# Can ERCOT be held accountable for its errors?

**L.M. Sixel**

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General Manager Darryl Nitschke makes the rounds of the Panda Power Plant in Sherman, Texas, north of Dallas, on Tuesday, September 10, 2019. The power generator depended on the grid manager in Texas to provide accurate forecasting and built three plants -- including the one in Sherman -- because the grid manager said Texas needed more power. ...

Photo: Louis DeLuca

Panda Power built three power plants earlier in this decade, investing billions of dollars based on projections from the state's grid manager that Texas desperately needed more generation to meet growing electricity demand. But those projections turned out to be wildly wrong — Texas, in fact, had plenty of power — and Panda

ended up losing billions of dollars and putting one of the plants into bankruptcy, unable to sell electricity at prices sufficient to cover debts.

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The Dallas company is now in court, alleging that the Electric Reliability Council of Texas intentionally manipulated the projections to encourage new power plant construction and relieve the political pressure that was building on the grid manager to increase generation in the state. The case has implications that reach beyond whether Panda gets its money back to issues as profound as the reliability of power grid, the integrity of the wholesale electricity market and the accountability of an organization whose decisions affect thousands of businesses, millions of people and billions of dollars.

The Texas Supreme Court is considering whether ERCOT, a private, nonprofit corporation, is entitled to its sovereign immunity, a well-established legal principle that protects governments and their agencies from lawsuits. The high court's decision, expected later this year, could determine whether electricity buyers and sellers can hold the grid manager responsible for pricing errors, mistake-ridden forecasts or life-and-death consequences of power outages.

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These problems aren't just hypothetical. After a data error this spring forced electricity buyers to pay millions of dollars more than they should have, ERCOT declined to reprice the power, arguing that such errors are so frequent that continual repricing would disrupt the electricity market.

ERCOT's job is to maintain confidence in the electricity market on which the state and its economy depend. Reliability is the cornerstone of its mission. But if under the protection of sovereign immunity ERCOT has carte blanche to make unfounded claims or allow price manipulation to fester, the grid manager risks its credibility to fairly and transparently manage the power market, analysts said. That in turn may discourage investment in the generation that the state needs to meet electricity demand.

“It makes it riskier to invest in Texas power because of immunity,” said David Coale, a Dallas lawyer who handles cases on sovereign immunity. “Maybe I’ll take my money to Nebraska.”

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ERCOT is the only grid manager in the nation with sovereign immunity. ERCOT, in court filings, argued that it needs immunity from lawsuits because it is funded by transaction fees paid by power generators and a big damage verdict would mean it would have to allocate the cost among the generators, which in turn, would pass it along in the form of higher electricity prices.

ERCOT says sovereign immunity doesn’t make it less accountable; it is overseen by the Public Utility Commission and Texas Legislature and accountable to both. “No pending dispute will change that fact,” said ERCOT spokeswoman Leslie Sopko.

## The good life

The Public Utility Commission sets the rules for the state’s deregulated electricity markets, delegating the day-to-day management of the power grid to ERCOT. The commission operates from two floors of crammed cubicles in the William B. Travis State Office Building, a dilapidated structure close to the campus of the University of Texas at Austin. DeAnn Walker, the commission chairman, earns \$189,500 a year.

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ERCOT is headquartered in Taylor, a 30-mile drive from downtown Austin. Its sprawling, modern glass and metal building has plush interiors with on-site fitness facilities that include a gym and sport court for volleyball, basketball and pickleball. ERCOT chief executive Bill Magness earned nearly \$750,000 in 2017.

ERCOT, which receives no government funding, reported nearly \$232 million in revenues in 2018, mostly from the fees generators, traders and retail electricity companies pay when buying and selling power on the wholesale market. ERCOT is run by a board dominated by power industry representatives. The Public Utility Commission chairman has a seat on the board, but no voting power.

ERCOT was in trouble from almost the very beginning of deregulation. Five ERCOT employees, including the chief information officer and director of information technology, went to prison in 2006 and 2007 over a \$2 million fake billing scheme for security services that included paying the wages of non-existent employees, including a dead man.

Five ERCOT  
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The scandal, triggered by suspicious ERCOT employees who alerted the Public Utility Commission, shined a light on the lack of transparency at ERCOT, which had fought outside audits and sought to uncover the identity of the whistleblowers.

ERCOT also came under fire because it couldn't secure enough power and resorted to rolling blackouts, enraging residents and lawmakers alike. By 2008, Texans living in the deregulated parts of Texas were paying nearly 30 percent more for power than the nationwide average. Wholesale prices spiked so many times that five retail electric providers went out of business.

But power prices on average were too low to provide generators with enough incentive to build new power plants. ERCOT needed a way to convince generators that building was in their best interests, Panda alleged in court documents.

ERCOT issued reports in 2011 and 2012 that Texas was facing a serious shortage of electricity, a message reinforced in press releases and presentations. Rating agencies relied on the information to provide favorable bond ratings for companies taking on construction debt to build power plants in Texas.

Panda Power invested \$2.2 billion to build three power plants, including one in Sherman and two in Temple. The Sherman Economic Development Corp. supplied the land for the Sherman plant, anticipating it would become Sherman's biggest taxpayer, according to court records. At the 2012 groundbreaking, Panda Power was thanked by the Public Utility Commission for helping to relieve pressure on the Texas grid.

By the next year, however, the Texas electricity market had more than enough capacity, reflecting new generation coming online, including several new wind projects that would depress the cost of power. It became increasingly clear to

ERCOT that it had relied on “seriously flawed or rigged” information to forecast the earlier shortages, but never corrected the errors as is it sought to encourage power plant construction, Panda Power said in court documents.

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Panda sued ERCOT in state court in 2016, alleging fraud, negligent misrepresentation and breach of fiduciary duty. Panda Power is seeking \$2.7 billion in damages.

### ‘Destabilizing blow’

Panda’s case got a boost when a former employee came forward and testified he was instructed by ERCOT officials to change information he gathered from generators for calculating electricity demand. But the case stopped in its tracks two years ago when ERCOT filed an emergency petition with the appeals court in Dallas, asserting that it was protected from lawsuits by sovereign immunity, a claim the trial court had rejected.

The appeals court, however, sided with ERCOT. Panda Power subsequently asked the Texas Supreme Court to intervene – arguing in court documents that the appeals court delivered a “destabilizing blow” to the competitive electricity market in Texas, which demands accuracy, transparency and accountability from ERCOT.

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Werner A. Powers, a Dallas lawyer representing Panda Power, said it’s a dangerous precedent for the government to give sovereign immunity on the actions of a private organization whose board of directors is drawn primarily from profit-making businesses.

“Our case involves alleged fraud causing financial loss,” he said, “but the next case might involve loss of life where ERCOT allegedly acted in a grossly negligent or irresponsible way by shedding power needed by a hospital or by a home for the elderly.”

ERCOT has argued in court documents that it prepares the forecasting reports at the direction of the Public Utility Commission and includes disclaimers the reports may contain errors and should not be relied upon. If ERCOT is to be sanctioned, that should be the responsibility of the Public Utility Commission — not the courts, the grid manager contended.

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Felix Mormann, a law professor at the Texas A&M University School of Law who specializes in energy law, said ERCOT is essentially doing a government function. Without sovereign immunity, ERCOT would have to buy costly insurance to protect itself from financial losses from lawsuits, he said.

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“We know who would have to pay for it,” Mormann said, “and that is ratepayers.”

But other energy experts say ERCOT acts more like a trade group than a government agency. Its board is dominated by power industry representatives and it has its own rules on public access to meetings and records, which are more limited than the state’s sunshine laws.

If ERCOT is to be covered by sovereign immunity, it should be reconstituted as a government agency with the board appointed by the governor and subject to open

meeting and public record laws, said Robert McCullough, a Portland, Ore. energy analyst who follows deregulation issues. That would make the governor ultimately responsible

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“We know where the governor lives,” said McCullough.

## Generation inflation

ERCOT's accuracy came under fire again in August when Mauricio Gutierrez, the CEO of the power company NRG, told investors that ERCOT included out-of-date information in its May forecast of electricity supply and demand that painted a picture of healthier reserve margins, the extra power available when demand skyrockets and taxes electricity supplies. That forecast included the availability of 1.7 gigawatts of capacity from three natural gas plants that already had been delayed an average of five years with no signs of moving forward and another 1.4 gigawatts of generation slated for shutdown.

ERCOT also overestimated the amount of power likely to be generated from wind and solar projects over the next three years, according to NRG. One gigawatt provides enough power for about 700,000 homes.

NRG's estimates mean the state's reserve margin is even tighter than the record low that ERCOT forecast earlier this year. The importance of accurately forecasting reserve margins came into sharp focus last month as wholesale electricity prices in Houston soared to the maximum price allowed in Texas, \$9,000 per megawatt hour — compared with an average of \$36 last year — and stayed that way for several hours, requiring ERCOT to call for conservation measures to avoid rolling power outages.

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August wasn't the first time this year that power prices jumped to \$9,000 per megawatt hour. The Houston merchant power company Calpine erroneously reported in May it was taking 4,000 megawatts of generation out of service, leading power prices to surge to \$9,000 per megawatt hour before the mistake could be

fixed. Aspire Commodities, a Houston electricity trader, said the error created about \$18 million in windfall profits for generators and asked the Public Utility Commission to force ERCOT to reprice the trades. ERCOT has refused to do so.

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With sovereign immunity, ERCOT doesn't have to take responsibility for such mistakes and their costs, said Ed Hirs, an energy economist at the University of Houston. Ultimately, he said, consumers will pay more, with little recourse.

If ERCOT keeps its sovereign immunity, Hirs said, it would likely take a disaster — such as widespread blackouts, or political fallout from consumers paying higher and higher power bills — for the Legislature and governor to do something.

“Then,” he said, “we’ll see some action.”

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