

The Honorable Lois Kolkhorst
2000 S. Market St. #101
Brenham, TX 77833

The Honorable Donna Campbell
229 Hunters Village, Ste. 105
New Braunfels, TX 78132

The Honorable Robert Nichols
229 Hunters Village, Ste. 105
New Braunfels, TX 78132

CC:

Committee on Business and Commerce, Texas State Senate

Honorable Members:

Charles Schwertner, Chair

Phil King, Vice-Chair

Brian Birdwell

Brandon Creighton

Nathan Johnson

José Menéndez

Mayes Middleton

Judith Zaffirini

Dear Senators Kolkhorst, Campbell, and Nicols:

I am writing to share Kerrisdale's views on an area of directed study for the Committee on Business and Commerce: the impact of bitcoin mining on the Texas electric grid and whether changes should be made to ERCOT demand response programs. During the course of Kerrisdale's research into one particular bitcoin miner – Riot Platforms – we uncovered certain troubling aspects of their participation in demand response programs last August. We believe our findings may be of interest in your ongoing analysis of the issue.

Our research strongly suggests that Riot knowingly took advantage of rules designed for grid management to offset inefficient operations at its Rockdale facility. Riot's participation in demand response was designed to exploit a form of regulatory arbitrage which your previously proposed bill, S.B. 1751, rightly sought to address.

What we believe has been missing from the public record is a more fulsome explanation of *why* Riot participated to the extent it did last summer, profiting millions from energy regulations while Texans

were left to suffer in extreme heat. By understanding the motivations behind Riot’s power strategy, we believe lawmakers can, and will, craft policy better suited to bitcoin mining’s unique business model.

In addition to this letter, we have sent a letter to the Navarro County Commissioners Court detailing our concerns over Riot’s operations at Rockdale and its purchase of \$453 million worth of bitcoin mining equipment from Chinese manufacturer, MicroBT. ¹ If future domestic production of bitcoin is strategically important (as a representative from Riot testified before the Committee²), how does Riot justify perpetually and massively enriching Chinese bitcoin mining and infrastructure providers? We find it extremely concerning that bitcoin miners like Riot post consistently poor financial results³ despite the benefit of generous energy and tax incentives, while Chinese companies enjoy enormous profits at the expense of U.S. taxpayers.⁴

Please note that Kerrisdale is short shares of Riot and we provide a link to full disclosures at the end of this letter.

Riot Platforms’ Participation in Demand Response Programs

As you are aware, in August 2023 Riot earned \$7 million in cash payments under ERCOT’s ancillary market demand response programs, part of \$22 million received during all of 2023.⁵ Under this arrangement, the company competitively bids to sell ERCOT the option to control Riot’s electrical load in certain hours. Riot receives payment regardless of whether ERCOT asks it to curtail or not.⁶ In reality, curtailment requests from ERCOT are very infrequent, less than 3% of the time according to an industry peer.⁷

Yet Riot also earns lucrative energy credits under the terms of its power purchase agreement with TXU Energy when it chooses to power down during a spike in energy prices. For instance, in addition to the payments from the ancillary market, in August 2023 Riot earned \$24 million in energy credits from a 345 MW long-term, fixed-price power purchase agreement (PPA) which allows Riot to sell power back to the grid based on the spread between the fixed price and spot power prices when it is economically beneficial for Riot to do so. This is an incredibly attractive arrangement for Riot – as Senator Nichols correctly surmised during testimony before Business & Commerce Committee last March, power prices during extreme weather can surge upwards of 10x versus more normal conditions.⁸

Every day, bitcoin mining facilities are presented with a very simple, powerful, market-based economic decision based on the price of power and the price of bitcoin: mine or power down. In Riot’s case, curtailing operations during a heat wave can net the company tens of millions based on the terms of their power contract. So why is Riot participating in ERCOT’s ancillary market, whereby it must run operations unless ERCOT orders it to curtail, when it could instead simply power down in response to high energy prices pursuant to the terms of its PPA with TXU? In a sense, why is Riot receiving *millions* in Texas payor dollars to be *unresponsive* to soaring power prices?

The reality, contrary to the claims of the bitcoin mining industry’s lobbyists, is that some miners like Riot can’t always easily curtail operations as power prices fluctuate.

According to multiple interviews with an industry expert with detailed, firsthand knowledge of the Rockdale facility and insight into its operations, the mine’s infrastructure, network design, and contractual obligations with customers renders the turning off and subsequent quick ramp up of hundreds of thousands of computer servers a tricky and complex engineering problem. This is particularly true during extreme heat, as the facility, which is situated in dusty and humid East Texas, has design flaws which do not allow for heat generated from its mining equipment to dissipate properly. Note, this dim view of operations at Rockdale is corroborated by others. “Substandard operating conditions” and criticism of Rockdale’s design are core allegations in two ongoing legal disputes between Riot and two of its former hosting customers.⁹

Riot’s bidding strategy in the ancillary markets last August was borne out of these operational failings. In effect, Riot decided to participate in a program it knows will not get called on often. Essentially, Texas taxpayers are generously and *needlessly* doling out tens of millions of dollars to Riot. As a representative of ERCOT stated before the Committee last March, restricting bitcoin miner participation in demand response programs would have no bearing on grid stability.¹⁰ Grid incentives paid to bitcoin miners like Riot wastes Texas tax dollars.

Kerrisdale supports and urges you to continue seeking more information regarding the operations of bitcoin miners and to ultimately implement much needed, common-sense limits to their participation in demand response programs.

Sincerely,

Sahm Adrangi
Chief Investment Officer
Kerrisdale Capital Management, LLC

Disclosure: Kerrisdale Capital Management and its affiliates (collectively, “Kerrisdale”) are short shares of Riot Platforms and stand to realize gains in the event that the price of the stock decreases. Please read our full disclaimer at kerrisdalecap.com/legal-disclaimer-3.

¹ Riot Platforms, SEC Form 10-K for fiscal year ended December 30, 2023, F-24.

² The Texas State Senate Committee on Business & Commerce, March 28, 2023. Timestamp: [1:06:59](#).

³ Riot Platforms, SEC Form 10-K for fiscal year ended December 30, 2023, F-45. Riot has reported negative net income the past three years.

⁴ The situation recalls the old adage of “it’s better to sell picks and shovels during a gold rush than dig for gold.”. Rather than lamenting any lost “strategic importance” from their self-imposed ban on crypto mining in 2021, we suspect the Chinese are more than happy to still profit from selling equipment to US-based crypto miners and benefit from the boom without the associated risk and negative externalities.

⁵ Riot Platforms, August 2023 Production and Operations Update, September 6, 2023.

⁶ Riot Platforms, SEC Form 10-K for fiscal year ended December 30, 2023, F-28.

⁷ CNBC: Bitcoin miners are helping the Texas grid brace for winter storm impact, February 3, 2022.

⁸ The Texas State Senate Committee on Business & Commerce, March 28, 2023. Timestamp: [58:35](#).

⁹ On April 5, 2023, SBI Crypto Co., Ltd. filed a complaint in the United States District Court for the Western District of Texas (Case No. 6:23-cv-252), which it later amended, alleging breach of contract, fraud, and negligent bailment claims. On June 13, 2022, GMO Gamecenter USA, Inc. and its parent, GMO Internet, Inc., (collectively “GMO”) filed a complaint against Riot subsidiary, Whinstone, alleging breach of contract under the colocation services agreement between GMO and Whinstone, seeking damages in excess of \$150.0 million. The case is pending in the United States District Court for the Southern District of New York (Case No. 1:22-cv-05974-JPC).

¹⁰ The Texas State Senate Committee on Business & Commerce, March 28, 2023. Timestamp: [1:15:09](#)