

STAKEHOLDER SOAPBOX

Organized Markets for the Future

By Rob Gramlich

As soon as new commissioners are seated at FERC, they will have fundamental and controversial market design questions to resolve.



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Some of those questions will be decided in states in terms of the benefits of those policies to those states, and some will be decided by courts in terms of their legality. For their part, the new commissioners will need to choose sides in the never-ending supplier vs. customer debate on capacity obligations and markets.

Or will they?

The Great Divide

The FERC technical conference on potential conflicts between state policy and RTOs/ISOs on May 1 and 2 revealed the same splits as in 2013 and previous commission reviews of capacity markets. Suppliers believe prices should be higher to attract and retain needed resources, while wholesale customers believe capacity markets fail to serve their needs. The main outcome of the 2013 review, which was to improve price formation, has helped a little, and more can still be done there to reflect scarcity in prices.

Carbon pricing was endorsed by many participants as the best economic policy solution for current market challenges, but that doesn't seem to be a silver bullet either, as putting it in FERC-jurisdictional tariffs was not widely embraced by states. Searching for a third way, ISO-NE and PJM introduced proposals to raise capacity market prices. But explicitly discriminating between supply sources in terms of eligibility and pricing based on someone's determination of what is "subsidized" and by how much seems hardly like a way to reduce litigation. The higher capacity prices will also lead to further unneeded entry on top of today's generation surplus that customers will not be happy about paying for.

So this customer-supplier divide remains. And PJM's recent Capacity Performance

changes, now in litigation, created more capacity market enemies by preventing their renewable energy resources from selling their capacity value. No wonder there was so much frustration at the conference.

What if we re-evaluate the fundamental objectives of capacity obligations? Do some of the debates become moot?

Mandatory Capacity Obligations No Longer Necessary?

When FERC reluctantly accepted mandatory capacity obligations on load-serving entities in the early 2000s, it was for three reasons that may no longer exist: 1) "resources take years to develop," 2) "spot prices that are subject to mitigation measures may not produce an adequate level of ... investment" and 3) "regional resources are made available to all regional load-serving entities" with no ability to curtail those customers who failed to procure enough.¹

Point 1 is no longer true, with demand response and batteries now able to enter markets and provide peak energy within six months. Point 2 can be fixed with scarcity pricing and raising offer caps. Point 3 may not be true any longer either, with improvements in metering, control and scarcity pricing. So maybe capacity markets are only fighting the last battle and failing to solve future challenges.

Resource Adequacy Responsibility in the Future

The commission appropriately wants to make sure someone is responsible for generation meeting load at all times. As with any market in any sector, primary responsibility should be put on customers to procure the supply they need. Wholesale customers today have a range of preferences in terms of resource types, fuel price risk management and environmental attributes.

Some LSEs will be guided or required by states in their resource planning. Either way, their resource choices should be respected and supported to do most of the resource planning work. They have newfound abilities to cover themselves now that batteries can be deployed in six months with exactly as much as is needed, along with DR, in contrast to the past when they had to plan three

or more years ahead for lumpy generation assets.

Reliability when Scarcity Conditions Arise

When it comes down to real time, and scarcity exists, RTOs and FERC still need to make sure the system can be balanced. Scarcity conditions may occur at very different times of day and year than in the past, as we are seeing in California and other markets, given different load and supply stack shapes. Reliability during these scarcity conditions can be satisfied if either a) pricing prevents LSEs from demanding more power than is available, or b) the system operator can physically curtail loads that caused the shortage.

We should allow for the possibility that efficient real-time energy markets with today's pricing and control systems will do the job. RTOs could define short-term products purely according to system requirements and allow all sources to compete on a level playing field. Technology neutrality would help attract batteries, different demand sources and other new technologies to enter to serve system needs. ERCOT is closest to this market vision at this point, though it isn't fully there.

Completing the Transition

With primary reliance on bilateral contracting for resource adequacy and RTOs focused on their core mission of bid-based security-constrained economic dispatch in real time as a backstop, we can take the competition training wheels off and support a bright, clean, efficient and reliable future power system. We can accommodate rather than work against state policies. We can pull back on RTO mission creep and thereby encourage greater participation in the efficient regional energy markets that are needed for clean energy development in the non-RTO parts of the country. Let's see if we're ready to move past the old debates and design the RTO markets of the future.

¹SMD NOPR, July 2002, par.461, citing Power System Economics by Steven Stoft.

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