

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

State Policies and Wholesale Markets)
Operated by ISO New England Inc., New York)
Independent System Operator, Inc.,) **Docket No. AD17-11-000**
and PJM Interconnection, L.L.C.)

Comments of Rob Gramlich, Grid Strategies, LLC¹

The just and reasonable rate or charge for wholesale electricity is where supply and demand intersect, with all resources included. That has been the longstanding regulatory framework and would continue to provide the most workable, fair, and predictable framework going forward. It would be less efficient, potentially unworkable, and unstable to shift to a new framework of setting just and reasonable rates at levels artificially higher by excluding certain resources or raising their bids.

In bulk electricity markets, prices have been deemed just and reasonable when they are set by the intersection of supply and demand, as long as market power is absent or mitigated.

¹ I am currently an independent consultant. I have worked at AWEA, FERC, and PJM (<https://gridstrategiesllc.com/about/>) and have published articles on electricity markets (<https://gridstrategiesllc.com/articles-2/>).

This has been the general framework established by FERC and the courts since electricity competition began in the early 1990s.^{2,3,4}

Prices have been deemed just and reasonable even when public policies affected them. A wide range of state and federal policies have affected quantities and prices in power markets since the inception of US electricity markets. For example, there might not be any nuclear generation in operation were it not for the Price-Anderson Act limiting liability for unit owners. We might not have as much natural gas generation if intangible drilling costs were not allowed to be deductible as a current business expense under federal tax law. A large amount of generation participating in markets is part of a state regulatory rate base which affected the development of those sources and affects their ongoing behavior. The existence of these policies affects the amount of supply, the cost of that supply, the point at which supply and demand intersect, and the resulting price.

The regulatory framework has been to set market rules in a manner that accounts for public policies in the same way as other exogenous factors that impact markets. While FERC has deviated slightly from this paradigm in recent years through its expansion of the MOPR, the basic framework of treating public policies like other exogenous factors has generally held true since the establishment of organized wholesale markets.

² Elizabethtown 10 F. 3d. at 870 (DC Cir. 1993).

³ “[I]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment.” *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990).

⁴ Robert Gramlich, “The Role of Energy Regulation in Addressing Generation Market Power,” *Environmental and Energy Law and Policy Journal*, Vol 1. No. 1, 2005.

Just like a cost of production, a public policy is something that can affect a seller's willingness to accept or a buyer's willingness to pay. Quite directly, some generation owners must purchase sulfur dioxide allowances through EPA-regulated markets (that have existed for as long as power markets), and those suppliers may reflect the cost of such allowances in their sales or bid prices. Air emission regulations can affect allowable generation run times. Some policies may tend to raise certain suppliers' bids and/or prices such as emissions allowances, and others may tend to decrease bids and/or prices, such as renewable energy incentives. Markets have been deemed workably competitive and prices have been deemed just and reasonable by the Commission throughout the Northeast organized markets as well as the rest of the country with public policies affecting their outcomes.

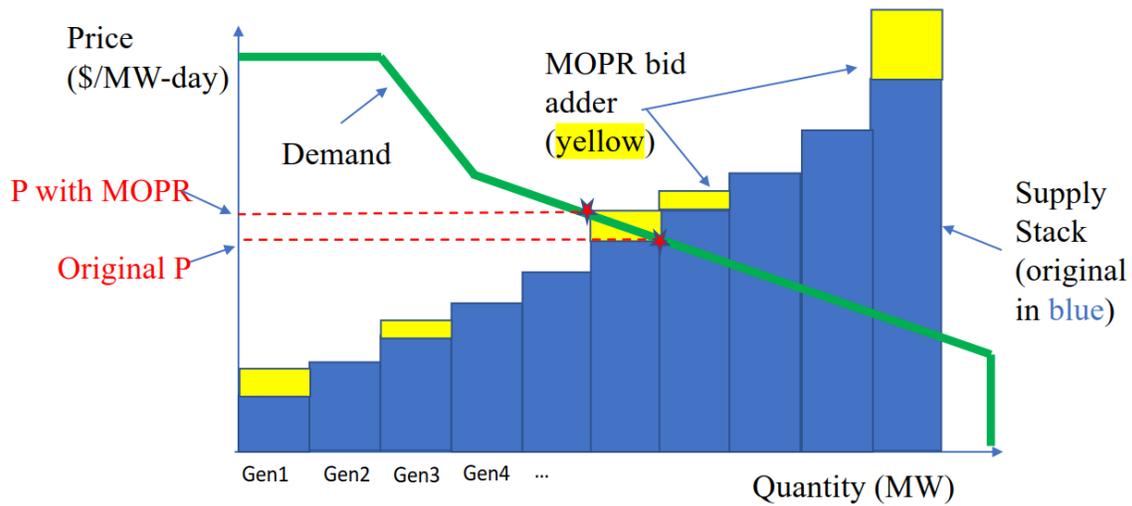
If public policies were to be mitigated, deterred, or otherwise specially adjusted for by the Commission rather than accounted for in the same manner as other exogenous factors, there would be no clear boundary governing when the Commission might intervene and when it might not. Policies vary in many dimensions: state vs federal, capital cost vs operating cost support, forms of insurance vs direct cost support, environmental vs economic development vs other social objectives, forms of zoning and resource access vs economic factors, and more. Sometimes impacts are direct and sometimes they flow indirectly from upstream sectors. Some policies such as Renewable Portfolio Standards do not pick a single technology or resource but allow a measure of competition. Determinations would need to be made on which policies count as "subsidies" and how to mitigate each one. Such decisions, subjective as they are, could easily be changed over time so there would be little regulatory certainty.

The specific “mitigation” options being considered in this proceeding provide no clear boundary and may have harmful impacts. Greater use of Minimum Offer Pricing Rules would likely lead to higher prices to consumers. Bids of certain units would be raised by MOPR, and those higher bids could set the price. While many resources would likely be infra-marginal in which case their bids would not affect the market price, according to ISO-New England, many would be high enough not to clear.⁵ Therefore it is very possible some would be on the margin, directly setting prices. Figure 1 below illustrates the raised bids due to MOPR (in yellow) setting a higher price than without MOPR. The ISO-NE market monitor said with the amount of policy-driven entry, “[t]he MOPR in this case is likely to significantly increase costs for New England’s consumers. It can also cause conventional new resources to clear the FCA inefficiently by preventing higher-cost renewables from clearing (even though they are committed to entering).”⁶ Moreover, consumers could essentially pay twice for capacity if they pay for a public policy that supports a resource that ultimately does not clear in the market because it is mitigated.

⁵ https://www.iso-ne.com/static-assets/documents/2017/06/a5_presentation_competitive_auctions_with_subsidized_policy_resources.pptx slide 9.

⁶ Comments of David B. Patton, PhD, Potomac Economics, AD17-11, p.4.

Figure 1: Higher Prices due to MOPR



Addressing public policy through re-pricing as is being discussed by PJM may also harm consumers. Re-pricing appears to create a gaming opportunity. Bidders would have the opportunity to receive a price that is higher than the marginal bid. They would have an incentive to bid under their marginal cost, taking a calculated risk that they might be accepted and paid an adjusted price that is far enough above their marginal cost to justify the risk of selling at below their cost. Bidders would be rational to guess and bet on such outcomes. That behavior would be inefficient because higher cost units may be chosen over lower cost units. It could also exacerbate the excess supply in the market since lower bids could meet the demand curve farther to the right, clearing a greater quantity.⁷ It could encourage inefficient units to stay on-line longer. There may also be an incentive to deviate from marginal cost bidding if a bidder believed its bid might be used to re-set the price but would not receive a capacity commitment. These deviations from an incentive to bid marginal cost could distort markets

⁷ Orvis and Gimon. <http://www.utilitydive.com/news/the-state-of-wholesale-power-markets-whats-wrong-with-proposed-changes-in/445417/>

similar to the “pay-as-bid” approach that was considered and rejected by RTOs and the Commission in the early 2000s.⁸

Further, the proposal would harm price convergence between bilateral and centralized markets. For example, a voluntary purchase of some of the output of a renewable energy project by a technology firm would have one price in a bilateral contract, and a different bid in the auction if a state passes a policy affecting the same resource. Such a difference would distort consumers’ decisions between bilateral and central market participation. The health of bilateral markets is at least as important as the centralized market, as many participants including renewable energy generators rely primarily on long-term bilateral contracting. Such contracting should be considered an important part of the market, not something that is “out of market.”

Markets would function better if the traditional boundaries were maintained governing intervention. Market power and market manipulation have been areas of FERC intervention since the beginning of competitive bulk power markets in the US. Public policy has been treated as exogenous, as a factor that may affect market participants’ behavior and willingness to pay or accept money for a transaction, but not something for the Commission to mitigate or undo. One can disagree with some of the laws state and federal legislatures pass, and FERC can offer its input into legislative processes, but it would be a major shift in the regulatory paradigm for the federal electricity market regulator to go beyond intervening to remedy market power and manipulation and enter the realm of mitigating public policy.

⁸ Kahn, Cramton, Porter, and Tabors, “Uniform Pricing or Pay-as-Bid Pricing: A Dilemma for California and Beyond,” *Electricity Journal*, July 2001, p. 70.