FERC Technical Conference on Local Market Power Mitigation and Methods of Compensating Must-Run Generators in Organized Markets

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I would like to thank the Commission and Commission Staff for holding this conference and inviting me to provide the California ISO's perspective on this important issue. This topic is of particular importance to the California ISO in light of its proposed new LMP market design.

Several points have been made today that I agree with and would like to reiterate and several points have been made that I don't agree with and would like to explain why.

We have heard a lot of discussion today about the need for "getting the prices right". I would like to offer several comments on this topic.

- First, I completely agree with Joe Bowring that in the absence of physical scarcity, the "right price" is the marginal cost of the highest cost unit needed to serve load.
- Second, I also strongly agree with Joe Bowring and others that local market power often has little to do with physical scarcity and more to do with a high level of ownership concentration within the a load pocket.
- Finally, in cases of true physical scarcity, scarcity pricing is appropriate. In fact, the CAISO's new market design proposal allows for scarcity pricing when there is insufficient supply to meet load. Scarcity with respect to low operating reserves within load pockets is, in my view, a concept that may have merit but such an approach needs to be better developed to be fully evaluated.

We also heard that high prices or the threat of high prices is necessary to provide incentives for new generation investment. The story goes, load will not forward contract without the threat of high prices and supply will not build without forward contracts. I believe this concept makes sense on a broader regional basis where entry is relatively easy and has less of a depressing effect on market prices. However, I don't believe the concept works very well in load pockets where entry is extremely difficult, requires long lead times, and is likely to have a significant impact in reducing prices within the load pocket.

If prices are not the answer for providing incentives for infrastructure development within load pockets, what is? We have to remember that scarcity and reliability problems go hand in hand so I think the answer lies in clarifying who has the obligation to serve load.

In California that obligation largely rests with the investor owned utilities. Today, as we sit here discussing this issue, several thousand miles from here the California Public Utilities Commission is holding hearings to assess the merits of a new transmission project into San Francisco. There, people are debating whether the new transmission is needed and assessing tradeoffs between building new generation, retiring older dirty plants and assessing the extent to which energy efficiency, renewable programs, and demand programs can replace the need for costly infrastructure investments. These are huge public policy issues with substantial environmental and social ramifications. If during these deliberations, energy prices in San Francisco where clearing at $1,000/MWh, I am not sure how that would accelerate new infrastructure development. In fact, I believe it would detract from such development.

Ultimately, this is a local resource adequacy problem that is best addressed by those directly responsible for serving load. Long-term planning with locational capacity requirements for load serving entities is the best approach to ensure adequate infrastructure in load pockets, mitigate local market power, and ensure suppliers within these load pockets are receiving sufficient compensation to cover their fixed costs. Local market power in procuring these long-term capacity contracts is mitigated by providing sufficient lead-time (e.g. 3 or more years) to negotiate these deals.

In summary,

- High LMPs in load pockets is not the solution,
- Marginal cost pricing is the "right price" absent physical scarcity
- Scarcity pricing under true physical scarcity has merit.
- Scarcity pricing under local reserve shortages may be appropriate but this proposal needs to be better defined.
- It is important that units critical for local reliability recover their fixed costs and the best mechanism for ensuring this is through long-term contracts with the LSEs in these load pockets.
- RMR contracts are a last resort (back-stop) mechanism for fixed cost recovery.
- The worst solution is trying to build scarcity and fixed cost premiums into unit bid caps. Such an approach is very imprecise and can be extremely costly to consumers if you get it wrong.

I will stop there and look forward to your questions.