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Comments of

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1. My name is Roy J. Shanker. My address is P.O. Box 1480, Pebble Beach, California, 93953. I am self-employed as an independent consultant.¹ I want to take this opportunity to thank the Commission for inviting me to participate in these discussions.

2. This technical session addresses an important challenge to the continuity of the valuable RTO core functions and associated benefits. As the Commission has recognized, a material and growing conflict exists between the basic competitive design and intended functions of the FERC jurisdictional electric markets and a myriad of state policies intended to subsidize politically preferable resources in the markets. As a daily observer of many of these markets in operation, it has become obvious to me that this fundamental conflict must be resolved as quickly as possible. Acting Chairman LaFleur aptly referred to the notion of the markets getting “cannibalized” absent an orderly resolution.²

3. The Acting Chairman identified three basic potential outcomes in her comments, and at a high level these may help guide the relevant analysis of this problem, and what I believe is the appropriate approach to resolution. Acting Chairman LaFleur suggested that the first alternative might be to find a market design solution that could retain competitive properties and accommodate state policies; the second would be to litigate the various alternatives to resolution; and the third, some form of re-regulation, hopefully well planned, or (undesirably), unplanned and occurring as the markets get cannibalized and lose reliability benefits.

4. The second alternative seems inevitable. Regardless of the path(s) chosen, some parties will litigate. This observation also points to the fundamental differences among parties that make any cooperative solutions unlikely. These differences become very apparent in looking closer at the Acting Chairman’s first and third alternatives. It also becomes clear to me that in the presence of such fundamental differences any path forward requires the Commission to exercise its

¹ I represent a wide variety of market participants in the eastern RTO’s, which are the focus of today’s discussion. However, these comments are solely my own, and do not necessarily represent those of any of my clients.

² Comments of Acting Chairman Cheryl LaFleur, NARUC Winter17 Tuesday General Session, recording at minute 37, available at <https://www.youtube.com/watch?v=7Av2hnmp0ek>. Specific reference is to a recording of the presentation, but similar comments were presented in various media reports.

full authority over wholesale markets in order to find a resolution that does not cannibalize markets.

5. While the Acting Chairman's first alternative sounds desirable, it simply is not feasible without making the type of disastrous compromises that jeopardize the fundamentals of the electric markets. The chasm between the goals expressed by individual state policies and the fundamentals of efficient and competitive markets is deep, and from my perspective these individual state goals and a well-functioning market are not simultaneously achievable. Typically the state policies are predicated on some form of discrimination, forcing specific winners and losers with respect to the supply of electric energy and capacity via rule or out of market payments and actions. Whether arbitrary or virtuous, such discrimination being implemented on a state-by-state or region-by-region basis is fundamentally inconsistent with efficient market designs and the basic jurisdictional authority of the Commission.

6. While it might seem possible to shove all of the stated objectives into a single patchwork design, the results will not match stated Commission objectives for competitive and non-discriminatory markets.³ For example, review of comments from the New England states regarding the Integrating Markets and Public Policy (IMAPP) process reveal a desire to: i) maintain direct control over their own decisions they wish manifest in the markets, e.g. pick winners and losers among suppliers in the wholesale markets; ii) maintain the ability to make sure that their individual state subsidies don't subsidize market participants from other states in the same market; iii) remove or evade the potential for FERC jurisdictional actions that might thwart their objectives; iv) avoid exposure to "double payments" reflecting the fact that the generation they choose to subsidize may not be recognized or "clear" in the RTO capacity markets; and v) at the same time, somehow maintain an efficient and "competitive" market and/or implement the discriminatory state policies within a "competitive structure."⁴

7. Similar comments have been made in other states. Though we are focused on the eastern RTO's, possibly the most transparent comments I have seen come from California where the CPUC explicitly stated that while a transparent, open and competitive central capacity market might be more efficient in the long run, it preferred to maintain a less efficient bilateral capacity market structure because of short run cost savings. Similarly it expressed concerns that a centralized market

³ See for example *ISO New England Inc., and New England Power Pool Participants Committee*, Order on Remand, 155 FERC ¶ 61,023 (April 8, 2016), one of a long series of orders and precedents by the Commission with respect to minimum offer rules, efficiency, non-discriminatory products, etc.

⁴ NESCOE Problem Statement (May 17, 2016), available at http://www.nepool.com/uploads/IMAP_20160517_Problem_Statement.pdf; NESCOE Comments on State IMAPP Objectives, IMAPP Plenary Meeting #4 (Sept. 30, 2016), available at http://www.nepool.com/uploads/IMAPP_20161006_Composite2.pdf.

under the CAISO might open the door to undesirable FERC jurisdiction and authority.⁵

8. It should be obvious that these conditions can not realistically be simultaneously met. Attempting to do so only invites the types of compromises in “best design” versus politics and advocacy that have plagued the eastern RTO’s market designs. Further, by inviting such compromises, we are led again to the dilemma of “bad rules make it difficult to discern the difference between bad market design and bad behavior”. In this case the continual backdrop to all of the discrimination is not simply a desire for “clean” energy, but also a desire or intent for the inherent price suppression that accompanies discriminatory payments, subsidies and the subsequent new artificially low cost supplies of both energy and capacity incentivized by such discriminatory policy.

9. At an operational level there is a fundamental disconnect between electric market commitment and dispatch solutions and payments (and associated investments) based on actual marginal costs versus solutions where state legislators or regulators “pick winners and losers” and subsidize these units’ participation in the markets. This disconnect impacts the financial terms that underlie other private market participants’ decisions regarding new entry, the ability to sustain generation investments, and operations in electric markets. It also shapes financial decisions regarding investment in transmission. Local preferences manifested as out of market payments or subsidies distort prices from what would be optimal in a “normal” market solution of price, quantity and social welfare. They represent an unknowable and continuing risk to unsubsidized market participants and their continued economic viability. This raises the cost of such participants to supply energy and capacity and discourages new private investment.

10. These two basic approaches (a “real market” versus a blend of subsidy and out of market payments) are not compatible. If directed payments and subsidies are desired, current market clearing designs are not viable, as unsubsidized resources that are otherwise competitive and part of an efficient solution are forced out of the market, while subsidized units, dependent on non-transparent payments displace them.

11. This doesn't mean that either the pure market solutions linked (loosely) to the status quo or an alternative solution reflecting a desire for “clean” power is necessarily better/worse or desirable/undesirable. What this does mean is that the Commission has to make a clear decision and choice as to which path RTO's and the

⁵ California Public Utilities Commission, *Decision on Phase 2 – Track 2 Issues: Adoption of a Preferred Policy for Resource Adequacy*, R.05-12-013, D. 10-06-018, at 62-64 (June 3, 2010) (see Section 3.6.2 in general for discussion of relative advantages and concerns related to a central capacity market).

states should follow in achieving this type of objective for markets within its jurisdiction, and then subsequently enforce a consistent solution. The issue should be resolved in terms of the relevant regulatory jurisdiction and the best representation of costs and/or externalities (i.e. what the Commission has stated as “monetizing” the externalities in the context of this conference). Recognizing this brings us to a consideration of the third alternative raised by Acting Chairman LaFleur: how do we get from here to there, preferably without irreparable damage to market participants?

12. The Acting Chairman’s comment regarding cannibalizing the market informs us very well of the results if nothing is done. The level of subsidized generation reflecting either environmental/clean energy concerns or the motivation for price suppression or other potential discriminatory objectives has clearly reached a tipping point. In general the state subsidized or mandated units under long term contracts participate as price takers in both energy and/or capacity markets, driving down prices, often below zero in the energy market.⁶ The progressively increasing level of negative prices are a blatant warning sign of the impacts of subsidies (federal and state) and associated state purchase mandates (e.g. RPS). The path of how to react is clear as to the resulting adverse effect on the financial viability of existing generation. Frequently having to pay to supply power is not a rational long-term business proposition.

13. Further, the drive for more and more subsidies in the presence of these circumstances is contagious. If one existing generator or renewable supplier seeks and receives these types of payments, other suppliers would be both irrational, and remiss, not to seek the same financial support themselves. The limited protections of the status quo (some form of minimum offer price rule) seem incapable of managing this level of onslaught. The net effect is the erosion of the financial viability for anyone without some form of out of market support. Everyone without support gets “eaten”.

14. But there are two “planned” exits from these problems in the form of regulatory action. The first, and most desirable from my perspective, is predicated on the Commission exercising its exclusive jurisdiction over all of the relevant electric markets.⁷ In the presence of a legitimate externality, e.g. the desire to

⁶ For example in California the number of negatively priced hours also has grown, soaring to more than 1,000 hours in 2016 from 588 in 2015. Statement of Mark Rothleder, Cal-ISO vice president for market quality and integrating renewables as reported in the April 21, 2017 MW Daily. See also Bloomberg financial discussion of negative pricing impacts on prices and transmission investment: <https://www.bloomberg.com/news/articles/2016-04-05/one-thing-california-texas-have-in-common-is-negative-power>.

⁷ I don’t intend to offer a legal opinion regarding the Commission’s jurisdiction under the recent Supreme Court decision *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016). However, it is difficult to identify any element in the wholesale electric market (energy, capacity, ancillary services and transmission) that is not being *directly* and materially impacted by discriminatory mandates

“decarbonize” our society, we know exactly what to do: internalize (monetize) the costs associated with the externality either directly or via mechanisms such as cap and trade. In turn, rather than face an ill-defined patchwork of compromises and discrimination, the Commission could impose a uniform carbon price adder for all generation based on its carbon intensiveness and an identified social value of carbon. Similar actions could also be legislated. This type of carbon adder alternative was one of the options put forth in New England, and directly rejected in comments from the states.⁸ The NESCOE members preferred a solution that maintained their ability to designate winners and losers versus a system that weighed and balanced the cost of environmental impacts.

15. Once internalized, on a uniform and non-discriminatory basis, the “chips will fall where they may”. There will be winners and losers, but they will be consistent with a coherent view of the value of the identified environmental externality and a uniform implementation of this impact via the Commission’s jurisdictional power. This type of approach, if implemented fast enough, could avoid the undesired cannibalization the Acting Chairman identified.

16. The second potential “planned” re-regulation is possible, but far less desirable. If the states truly wish to pick winners and losers and remain outside of any interference from the Commission in wholesale markets, they presumably could simply return to a vertically integrated structure with cost of service regulation, their own individual state mandates, and their direction to support specific types of generation. But this raises the inevitable question of who pays for the existing independent resources, i.e. those without subsidies or contracts. With the status quo, and no further solution, these suppliers are the cannibalized resources. My expectation would be that with an explicit state mandate to re-regulate, the major issue would be how to procure these resources and fairly compensate their owners. This is a far more complicated issue than I am prepared to address today, but one which the Commission and the states must address if they fail to take the first path I identified above.

17. This concludes my introductory comments, and I am happy to discuss the above as well as the questions identified for the panel.

driven by state policy actions. Price taking energy and capacity offers linked to these mandates directly impact price formation. The intermittent nature of virtually all RPS resources requires material modification of dispatch and significant increases in flexible resources and associated ancillary services. “Bunched” wind facilities have driven and are driving huge expenditures on new transmission to move power from remote generation sites to load.

⁸ Id.