

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

Grid Reliability and Resilience Pricing )

Docket No. RM18-1-000

**COMMENTS OF THE  
SOUTHWEST POWER POOL MARKET MONITORING UNIT  
ON NOTICE OF PROPOSED RULE BY THE SECRETARY OF ENERGY**

The Southwest Power Pool, Inc.’s (SPP) independent Market Monitoring Unit (MMU) respectfully submits comments in response to the Secretary of Energy’s proposed rule for final action by the Federal Energy Regulatory Commission (Commission) on “Grid Reliability and Resilience Pricing”<sup>1</sup> (Proposed Rule).

In the Proposed Rule, Secretary of Energy Rick Perry (Energy Secretary) proposed that the Commission exercise its authority to establish just and reasonable rates for wholesale electricity sales by imposing rules on each Independent System Operator (ISO)/Regional Transmission Organization (RTO) with capacity markets to ensure that certain reliability and resilience attributes of electric generation resources are fully valued.<sup>2</sup> While the SPP markets do not include a capacity market, the SPP MMU respectfully submits that the SPP markets provide insight into the adverse consequences of policies designed to preserve capacity that would otherwise be uneconomic in typical ISO/RTO markets.

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<sup>1</sup> *Grid Resiliency Pricing Rule*, 82 Fed. Reg. 46,940 (Oct. 10, 2017) (hereinafter referenced as “NOPR”).

<sup>2</sup> NOPR at 46,940-41.

The SPP MMU challenges and opposes the Proposed Rule on the following fundamental grounds: First, resiliency, which is the central term used in this proposal, lacks specificity and should be defined more actionably and measurably. Second, competitive markets are the best approach to meeting economic and reliability needs in electricity markets and should not be distorted and disrupted by adding out-of-market pricing mechanisms for certain categories of generators. Finally, if the Proposed Rule is implemented, the SPP market currently demonstrates the likely negative consequences on electricity markets of the Proposed Rule, which need to be addressed in the SPP market and avoided in other ISO/RTO markets.

## **I. SPP MMU COMMENTS**

The SPP MMU urges the Commission to reject the Proposed Rule as adverse to the established competitive electricity markets operating in the ISO/RTO regions. Adoption of the Proposed Rule would only distort and disrupt the competitive markets and set back by decades the significant progress made in ensuring reliability of electricity service that the Commission's rules for ISO/RTO-operated markets established.

### **A. Resiliency is not well defined.**

The term resiliency in the Proposed Rule is not well defined and needs to be specified in more concrete and measurable terms in order for any version of the Proposed Rule to be considered. While the Staff Report to the Secretary on Electricity Markets and Reliability<sup>3</sup> ("DOE Staff Report") provided a definition for resiliency,<sup>3</sup> the definition is not clear enough to make it actionable in the ISO/RTO markets. Resiliency needs to be defined so that it is clear, measurable, and transparent. For example, SPP defines minimum capacity margin requirements at 12 percent,

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<sup>3</sup> U.S. Department of Energy, Staff Report to the Secretary on Electricity Markets and Reliability, at 63 (Aug. 2017) (hereinafter referenced as "DOE Staff Report").

which is a clear and measurable means of ensuring reliable capacity to meet peak demand.<sup>4</sup> The Proposed Rule’s definition of resiliency lacks this level of clarity. Furthermore, the DOE Staff Report affirms this observation stating, “[m]ore work is needed to define, quantify, and value resilience.”<sup>5</sup>

The concept of reliability of the electricity system has both short and long-term implications. This distinction has not been clarified in the Proposed Rule. Short-term reliability (i.e., moment-to-moment supply security) has been achieved more successfully by the organized markets compared to non-ISO/RTO structures thanks to central dispatch, more diversified generation and reserve portfolio features of the organized markets. Also, “fuel-secure” generation, as referred to in the Proposed Rule, may not always mean “supply-secure” generation, as short-term reliability often depends on ramping capabilities and flexibilities of generating resources that baseload coal and nuclear generation often lacks. The proposal that generators must maintain 90 days of onsite fuel supply to be eligible for cost recovery is ambiguous since what constitutes a 90-day onsite fuel supply would depend on the estimated daily coal use for non-baseload coal units and their market schedule or dispatch.

Long-term reliability of the electric grid, on the other hand, relates to more than just sustainability of fuel resources and technologies used in generation, as well as fuel security. Reliability also inherently depends upon the availability, condition and reliability of the electric transmission and distribution infrastructure, an important element not given due weight in the Proposed Rule. For example, planning the transmission system per NERC Reliability Standards

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<sup>4</sup> See SPP Planning Criteria, Revision 1.4, Section 4.1.9 (effective 7/25/2017).

<sup>5</sup> DOE Staff Report, at 100.

and SPP’s recent investment of \$3.4 billion from 2012 through 2014 in transmission projects already provides an estimated benefit of hundreds of millions of dollars annually.<sup>6</sup>

The argument that “...organized markets do not necessarily pay generators for all the attributes that they provide to the grid, including resiliency”<sup>7</sup> can be better evaluated once the concepts such as resiliency and reliability are defined more clearly. This view is consistent with the assertion made in the Proposed Rule that “...further efforts should reflect *urgent* need for clear definitions of reliability-and resilience-enhancing attributes and should *quickly establish* the market means to value or the regulatory means to provide them.”<sup>8</sup> The Secretary’s proposal posits a solution for a problem that the DOE Staff Report itself indicates requires further clarity.

However, if the term resiliency is meant to promote fuel and supply security for certain generation technologies, such as coal in particular, the DOE Staff Report provides a robust argument for *fuel neutrality* for managing risk and achieving reliability efficiently. The report noted that:

Fuel neutrality is essential for both monopoly-utility resource planning and competitive markets to manage risk and achieve reliability efficiently. Interventions to promote specific fuel types—such as bailouts for coal and nuclear or mandates and subsidies for renewables—skew investment risk and can undermine incentives for reliability-enhancing behavior (e.g., a public intervention to finance pipeline expansion removes incentives for the private sector to invest in fuel security). ... Ultimately, the central aim of market design should remain to procure specific reliability attributes at the least cost.<sup>9</sup>

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<sup>6</sup> Southwest Power Pool, Inc., “The Value of Transmission,” at 4 (Jan. 26, 2016) (available on the SPP Internet website at:

<https://www.spp.org/documents/35297/the%20value%20of%20transmission%20report.pdf>).

<sup>7</sup> NOPR at 46,942.

<sup>8</sup> *Id.* at 46,943 (quoting DOE Staff Report, at 10 (emphasis in original)).

<sup>9</sup> DOE Staff Report, at 90-91 (quoting Devin Hartman, “Why Risk and Reliability Matter More than Fuel Diversity,” *R Street Shorts No. 39* (May 2017) (available at <https://www.rstreet.org/wp-content/uploads/2017/05/RSTREETSHORT39.pdf>)).

**B. The proposed solution does not rely on a competitive market process.**

For over 20 years, the Commission has promoted competitive electricity markets and based these markets on the principle that economics and reliability are inseparable. To the extent that reliability enhancements are required, the SPP MMU respectfully submits that a competitive market solution be developed to meet the reliability requirement, rather than a predetermined approach such as the solution identified in the Proposed Rule. Competitive market constructs have been the basis of the development of electricity markets for over the last two decades and should remain so going forward.

The majority of the U.S. power sector has already achieved a certain level of competitive maturity after years of legal, regulatory and market progress, and the Proposed Rule would bring new out-of-market cost recovery guarantees for some preferred fuel and generation types. The Proposed Rule would reintroduce a model that can only survive under a regulatory regime. This would be in conflict with a broad consensus achieved on competition in the marketplace so far and amount to a *policy reversal* that will inevitably signal a credibility issue for public policy.

Building a competitive marketplace was a fundamental premise of the Energy Policy Acts of 1992<sup>10</sup> and 2005,<sup>11</sup> followed by relevant Commission orders, including the landmark Order No. 888<sup>12</sup> and Order No. 889,<sup>13</sup> which have not only reaffirmed the commitment to the reliance on

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<sup>10</sup> Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992).

<sup>11</sup> Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

<sup>12</sup> *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC STATS. & REGS. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, FERC STATS. & REGS. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

<sup>13</sup> *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, FERC STATS. & REGS. ¶ 31,035 (1996), *order on reh'g*, Order No. 889-A, FERC STATS. & REGS. ¶ 31,049 (1997), *order denying reh'g*, Order No. 889-B, 81 FERC 61,253 (1997).

competitive market rules, but also required tremendous effort on parts of the government, ISOs/RTOs, market participants, and stakeholders to implement. The development and entry of new technologies in the industry also served as a major impetus for competition. Renewable generation resources, in particular, are now more diversified and larger.

The vertically integrated utility model operates under various regulatory guarantees and, in many ways, undermines the competitive model. Generally, under that model excess generation capacity is maintained—and *artificially* sustained—by way of regulatory pricing and cost recovery schemes that had come under criticism since the early 1960s. Strong arguments for inefficiency of the regulatory model have resulted in restructuring of the power sector in many states in the late 1990s followed by the establishment of organized competitive electricity markets. While ISO/RTO markets continue to evolve, the SPP MMU believes that this competitive path provides for an approach by which different technologies and companies can compete on economics to provide needed reliability products without predefining preferred technologies.

**C. SPP markets provide a case study for when capacity decisions are disconnected from market forces.**

The SPP market, which is dominated by vertically integrated utilities, provides an example of the potential difficulties that will be faced if the Proposed Rule is implemented. This is because the issues are intimately related to the ownership structure, regulatory rules and resulting incentives that allow generators to recover their operating and capital costs including the costs of long-term fuel and supply contracts, and onsite stockpiles of coal.

In general, the cost recovery guarantees prevent economic signals to be received by market participants, which would make the exit of an uneconomic unit less likely or for these participants to price their product in an efficient way. For instance, the SPP market has a considerably high capacity margin, currently trending above 40 percent compared to the 12 percent minimum

requirement in the SPP tariff.<sup>14</sup> The excess capacity distorts price formation in the competitive market by encouraging price insensitive offer/bid behavior and mutes price signals for others type of generating technologies.

Excess capacity combined with long-term coal contracts and resulting long-term supply agreements reduce the opportunity for coal units to be economically cleared in the SPP day-ahead market, resulting in large amounts of self-commitment (or price taking) behavior.<sup>15</sup> Market participants more often find themselves in a situation to self-commit their coal generating baseload units to be able to stay on-line as a way of making use of stockpiles of coal and minimize their losses. This puts downward pressure on wholesale prices, which in turn negatively influences revenue adequacy; this issue is currently a concern of many SPP market participants.

In sum, the excess capacity, which is a result of regulatory regime and cost recovery guarantees, creates a burden on ratepayers both through individual utility rate bases and on the SPP competitive market, by way of inducing sub-optimal bid and offer behavior. Should the Proposed Rule be adopted, the Commission should make careful consideration of these effects. To the extent that the definition of resiliency can be fully developed and clarified, and a market construct be properly crafted, this could provide guidance to SPP markets in how resiliency could be included in its market processes to help address its excessive capacity margins.

## **II. CONCLUSION**

The SPP MMU respectfully disagrees with the Energy Secretary's Proposed Rule. The Proposed Rule's problem statement remains vague and unclear. The Proposed Rule inappropriately posits a solution that does not rely on a competitive market construct to resolve the concerns, and inappropriately considers this to be a concern only for ISO/RTO markets with

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<sup>14</sup> The SPP capacity margin at peak load was 43 percent in 2016, down from 49 percent in 2015.

<sup>15</sup> Self-committed generation was around 50 percent of online capacity in 2016.

capacity markets, even though the SPP market provides insights into the consequences of policies that do not account for the economic principles and signals of competitive electricity markets. The SPP MMU believes that the costs of the Proposed Rule outweigh any benefits to ISO/RTO markets, market participants and consumers at large. The SPP MMU opposes the proposed rule and urges the Commission to reject the Proposed Rule's proposal to compensate certain types of generation units with out-of-market payments that will only serve to distort and disrupt the established competitive energy markets.

Respectfully submitted,

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Dated: October 20, 2017