

Publicly Owned Entity Sector Perspective on Integrating Public Policy Objectives into the Wholesale Electric Markets

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Both the ISO-NE Board and the New England States have requested the NEPOOL Sectors to provide more specific input on potential alternative solution spaces to integrate broader public policy objectives for the regional electricity sector with the existing wholesale electric market design. The States are obligated to achieve outcomes that are consistent with State energy policies and environmental laws. While the States have expressed a strong preference for utilizing sustainable competitive markets to achieve these objectives, achieving the outcomes associated with these energy policy and environmental objectives is most important.

This document attempts to provide some thoughts on potential “paths forward” for achieving these objectives. We come at this from the perspective that for process improvements, objectives and goals define the structures and design approaches and structure and design, in turn, drives outcomes. As a starting point, we need to agree on a set of desired objectives for the region before evaluating (or re-evaluating) specific structural and design alternatives to achieve outcomes consistent with those objectives.

Most of our thoughts have focused on implementing broad-based and longer term changes to the current wholesale electric market design. We also recognize that there may be nearer term actions that may be possible to help start us down the path of achieving the results contemplated by the broader based State policy objectives. Since it seems to be in vogue today, the Public Power Sector is not averse to considering a “Combo Platter” of short and long term initiatives to achieve the desired outcomes.

Overarching Objective

For this effort to be effective, we believe that it is important to develop an overarching objective that will help guide discussions. For Public Power, this overarching objective has been (and will continue to be) the following:

Maintain reliability at the lowest reasonable cost to consumers, taking into account the broad range of policy goals defined and agreed upon by policymakers within the New England States.

Public Power also recognizes that competitive market solutions can and should be used in achieving this overarching objective, but only where they actually deliver value to consumers.

ISO Objectives and State Policy Objectives

Based on the Participants Agreement, the Mission of ISO-NE is narrowly defined:

- a) Assuring the New England bulk power system conforms to proper standards of reliability; and
- b) Creating and sustaining economically efficient markets for energy, capacity and ancillary services.

The Policies and Markets Problem Statement circulated by the States does a good job of illustrating how such a narrow mission presents challenges in meeting the “states’ legal obligation to execute state energy and environmental laws.” Based on discussions within the Public Power Sector and discussions

with various State and other representatives, we believe there are at least three additional objectives that are not incorporated into the current ISO Mission. These are:

- a) Maintaining a diverse supply of fuels for producing and pricing electricity;
- b) Narrowing the gap between retail electric prices in New England and retail prices in other parts of the country; and
- c) Being good stewards of the environment.

The Current Wholesale Market Structure Drives Outcomes

The current centralized procurement structure of the wholesale electric markets puts the ISO in the role of being the single wholesale buyer and the single wholesale seller in the region. Effectively all generation gets delivered to the ISO markets at a price defined by the ISO Market Rules. Similarly, virtually all load gets served through the ISO markets at a price that is defined by the ISO Market Rules.

Because the current ISO Objectives do not reflect the overarching objectives that are codified in State laws and/or critical to the States and consumers in general, it is not surprising that the current ISO market structure is not delivering the outcomes required for the region to meet these policies. The exclusive emphasis on market efficiency contributes to these “sub-optimal results” with respect to meeting the requirements of these overarching objectives. Specific examples include the following:

- a) The concentration of new gas-fired generation in the resource mix, presenting commodity supply reliability concerns and adding to price volatility;
- b) Challenges to getting new low/no carbon resources to clear in the capacity markets; and
- c) Lack of trust in wholesale and retail market outcomes driving consumers to install “behind the meter” distributed generation whether or not it makes economic sense.

Two Paths to Achieving the Overarching Objectives

The region’s Public Power systems do not believe that the current system is meeting the expectations of the region’s electric consumers. We do not believe that putting additional “Band-Aids” on the current wholesale market rules will achieve the results that the States and consumers are looking for without either 1) changes and expansion of objectives ISO is trying to achieve through the current centralized procurement structure, modified as necessary to accommodate the revised objectives, or 2) changes in the wholesale market structure to reflect a coordinated planning and long-term procurement process designed to achieve outcomes that meet State energy and environmental policies, with ISO managing residual requirements not otherwise satisfied by the Coordinated Plan to meet reliability and market efficiency objectives.

If, as a region, we want to preserve the centralized, “single buyer, single seller” wholesale electric market structure, then as a starting point the ISO’s mission needs to be expanded to explicitly incorporate the additional energy and environmental policy objectives agreed upon by the States and the other stakeholders in the region. This would then allow consideration of alternative market design changes to achieve outcomes consistent with the broader and integrated policy objectives. Specific design alternatives to consider include the following:

- a) Revisit the issue of “tranches” in the capacity market, with (minimally) a defined tranche (or tranches) for resources that are not dispatchable and/or have limited fuel and/or low/no carbon emissions.
- b) At the recent Restructuring Roundtable meeting, Professor William Hogan and a number of others suggested replacing the current Forward Capacity Market construct with a “Texas-style” Operating Reserve Demand Curve (ORDC) structure that would allow energy market prices to get very high when the system starts getting short of reserves.
- c) Impose a substantially higher price for carbon (possibly for all uses) within the region.
- d) Other options?

On the other hand, if we cannot agree on an expansion of the current ISO Objectives, then we should pursue as a region development of a much different approach designed to achieve coordinated planning and long-term procurement of our needs. This would leave ISO in a position to manage any additional needs, and efficiently transfer supply and demand obligations through residual markets, to address short-term trends not met through the Coordinated Plan. While this approach requires much greater and more detailed definition, key steps along this path include the following:

- a) ISO works with State representatives and regional stakeholders to develop a set of incremental system design changes and resource requirements (the “Coordinated Plan”) to meet an integrated set of reliability, market efficiency and environmental policy goals.
- b) Responsibility for advancing these system design changes and procuring the identified resources on behalf of load interests would also be established as part of this process.
- c) Responsible parties would have a period of time (in advance of an annual delivery date) to implement system changes and/or procure resources. Such procurements may be through long-term contracts, short-term procurements and/or other mechanisms, with compensation mechanisms to be determined. Any such structure must be compatible with guidance from the Supreme Court in the *Hughes v. Talon* decision.
- d) After this “date certain”, ISO would be responsible for addressing any residual needs not otherwise met through the Coordinated Plan based on its existing short-term reliability and market efficiency objectives.

Observations and Conclusions

We believe that the New England region is rapidly approaching a turning point. Consumers have lost confidence that as an industry we can achieve the objectives that they believe are critical. Load defection is real, and electric consumers increasingly have options to meet their needs that very well could adversely affect the ISO’s ability to achieve its narrow objectives. Trying to “draw a line in the sand” and prevent these changes is certain to lead to more controversy and pressure for even more sweeping changes. The fact that retail electric prices in New England remain well above the national average (and are probably even more above the national average than they were in the late 1990s and early 2000s when we embarked on wholesale electric market restructuring) further underscores the need to get past “business as usual”. We believe that after 20 years of experimentation the time is right to once again consider “Big Ideas” and Big Changes” that are aimed at delivering value to the region’s electric consumers.

The region’s public power systems stand ready to contribute to this process.