



Transcript of CleanLaw: Joe Goffman Interviews Ari Peskoe about the FERC PJM Minimum Offer Price Rule, January 27, 2020

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Robin Just: Welcome to this episode of Clean Law from the Environmental and Energy Law Program at Harvard Law School. In this episode, our Electricity Law Initiative Director, Ari Peskoe, speaks with our Executive Director, Joe Goffman, about the Federal Energy Regulatory Commission's December, 2019 order on PJM's capacity auction. We hope you enjoy this podcast.

Joe: Hi Ari.

Ari: Hey Joe. Nice to be talking to you again.

Joe: We're here today to talk about an action that the Federal Energy Regulatory Commission took back on December 19th. One of the reasons we're focusing on it is that it's an illustration of how clean energy policy works, or in this case may not work, for people who pay attention to climate policy and the way that clean energy can advance. What we're going to be talking about today represents some pretty high stakes. In many cases, the states have played an important leading role in advancing clean energy through state electricity policies. But while the states are often first movers, they're equally often not the last movers and the complex architecture of the electricity system often plays a significant role in either amplifying or blunting state clean energy policies.

Joe: And from what FERC did on December 9th, we're looking at a situation where the latter, that is the blunting, of state clean energy policies seems to be what FERC has done. So Ari, with that introduction, why don't you lay out the basics and then we can start talking about some of the significance of the FERC action and how in the last couple of days stakeholders and the industry itself and of course the states themselves that are affected by the FERC action have responded to it.

Ari: One of FERC's responsibilities is overseeing the rules that govern electricity trading across state lines. About 25 years or so ago, FERC oversaw the development of interstate electricity markets overseen by these entities called RTOs or ISOs, regional transmission organizations or independent system operators. The idea behind these organizations is that they operate the grid independent of market participants, and initially these organizations ran energy markets. That is they figured out what was the least cost mix of resources that



was going to keep the system operational and they would tell the plants which ones we're going to operate, how much they were going to produce, and keep the transmission system reliable. One of these organizations is called PJM. It includes all or part of 13 states that stretch from North Carolina to Illinois. In addition to an energy market it also has what's called a capacity market and that's what's at issue here.

Joe: What does PJM stand for?

Ari: Oh well initially it stood for Pennsylvania, New Jersey, Maryland because the utilities in those states were the original members but it's since, as I said, expanded quite beyond that. So the capacity auction was approved in 2006. The idea was the energy market in its first few years wasn't leading to the sort of investment that FERC and market participants and states had hoped. In particular there were certain geographic locations within the footprint that may have been facing reliability problems due to generation shortages. The idea behind the capacity market is let's create an additional revenue stream for generators, and we're going to create this auction in a way that's going to ensure that the region as a whole has sufficient capacity to keep the lights on. So that's really the key guiding principle here, is make sure the region has sufficient capacity and let's do it in a low cost way. So that's sort of the background of what we're talking about here.

Joe: So the idea is that you want to make sure that the signal that there's demand for generation is sent to generators and investors. You send a signal through price, but you use an auction to make sure that the prices as low as possible.

Ari: Yeah, that's the basic premise behind the energy market, and that's the basic premise behind the capacity market as well. In the energy market, the idea was that generators would offer power based on their production costs. And in the capacity market, the idea was generators would offer their capacity, and other resources, demand side resources too, based on their going forward costs. That is how much money do they need to sort of stay in the market and not retire. Taking into account that they're also making money from the energy market, from ancillary services markets as well.

Ari: So maybe I could just get into what sort of the key change here was. So FERC has essentially declared invalid any non-market revenues. So any revenue that a generator or other resource might earn through a state clean energy program by selling renewable energy credits on the voluntary market to businesses that want to show how green they are. For example, self-supply, that is utilities that recover costs of generation through retail rates. Those are all examples of revenue that are not earned directly through PJM markets. And FERC says if you're one of those resources we're going to subject you to what's called the



minimum offer price rule or MOPR. And if you earn any of those revenues, no matter how much, you don't get to set your offer. You don't get to decide how much your offer's going to be into the capacity auction. It's actually going to be some combination of PJM and its internal market monitor that are going to administratively set that offer based on sort of generic determinations about what they feel certain technologies costs to develop.

Ari: So this minimum offer price had always been a part of the market, but it was very narrowly tailored and it was directed at concerns about market power, that is certain entities might be manipulating prices to their advantage. And that's something that certainly is within the core of FERC jurisdiction. But the December 19th order vastly expands that authority and turns this auction into something that is really designed for an exclusive set of what are called merchant generators that have developed through the PJM market construct and roughly make up about half the market today. So now these generators that have roughly supplied half of the capacity, now the market is explicitly designed for their benefit.

Joe: So I have a relatively simple question and then a two part question. And the relatively simple question or request is for you to explain why impairing the ability of the generator to set its minimum offer price is penalizing to that generator or is detrimental to that generator. And the second, the two part question, is I think at this point FERC's rhetoric about its move, which features words like market and efficiency, is probably in pretty wide circulation. But beyond the rhetoric, what actual rationale, if any, did FERC offer for this move?

Ari: So the likely consequence of this decision is that new clean energy resources that sell renewable energy credits or get other forms of support as well as new generators built by self-supplying entities, which is vertically integrated utilities, public power and cooperatives, are unlikely to clear the capacity auction. Because most people presume that the minimum offer prices set by PJM and the internal market monitor will effectively prevent these resources from clearing. They'll be too high.

Ari: So that's going to have a couple of effects. One, it means that PJM will end up buying more capacity than it needs to actually keep the lights on because these other resources, these clean energy resources that are supported by states like offshore wind for example, that development is going to go forward. Those resources will be there. They will be contributing to the system's reliability, but PJM will pretend that they don't exist for purposes of this capacity procurement.

Ari: So PJM will separately from those resources procure all that it needs to keep the lights on, pretending those resources don't exist. So they'll be buying more than



they need. That means consumers will pay more because if you're in a state that, for example, is supporting offshore wind it now may be slightly more expensive because that resource can't get any revenue from the capacity market. So it may need to get more from local rate payers and then you're also going to pay more to PJM, indirectly through your utility, because it's buying more capacity than it needs and presumably the prices are going to be higher as well since that's the whole point of this, is to raise prices.

Ari: So your second question is how does FERC justify all of this. The sort of buzzwordy term that's been around this issue for a few years is price suppression, this notion that states are sort of putting their thumb on the scale, picking winners and losers, and that's distorting market prices and has the effect of suppressing prices in the eyes of sellers in the market, right? Because if you're a generator, you want higher prices and you don't like the fact that these states are coming in and supporting certain types of resources and that can have the effect of, in theory suppressing the prices. So that's FERC's rationale, is to end this price distortion and this price suppression. The irony is that they're distorting prices in another direction by divorcing them from real reliability needs.

Joe: So that sounds like there are at least two problems. One in the form of a question, the actions by states that are being characterized as distorting prices. Aren't some of those actions entirely fair game for states such as promoting cleaner energy by way of reducing the externalities in the form of air and water pollution of energy production?

Ari: Yeah. So there's definitely a number of parties in this proceeding. I've made that argument. Institute for Policy Integrity, it provides some good explanation of this. That yeah, I mean you can't say your market's efficient unless you're accounting for externalities. And a number of the state programs, particularly renewable energy credits and zero emission credits, are in economists' views less than ideal at attacking those externalities such as carbon dioxide emissions. But they do aim to reduce those emissions and other harmful pollutants as well. So neither side can really claim the efficiency mantle here. FERC's market isn't efficient because it completely ignores those externalities. And the state policies are often not the economists' first best solution to economically reducing emissions, but they at least start to get there.

Joe: So is it unfair to characterize FERC's action as introducing its own expensive inefficiencies in order to offset its claimed state-generated inefficiencies?

Ari: I think that's a fair characterization. I mean the way that I think about it is that FERC's order is designed to exclude state preferred resources and has the effect of bringing in FERC's preferred resources. FERC's clear preference is this



merchant generation model which predominantly builds natural gas-fired power plants these days. In fact, we had a podcast some months ago with Jacob Mays who wrote an academic paper with FERC's chief economist arguing that the PJM capacity market and other similar markets are implicitly biased in favor of natural gas fired power plants just by the way the rules are constructed, and they're just ill-suited to finance renewables. So the effect of this decision is to double down on this model that implicitly favors FERC's preferred resource, which is a natural gas-fired merchant-backed power plant.

Joe: Now when you use the term "FERC's preferred resource," is that a preference implied by the effect of the policy action, or is it an explicit preference that FERC uses expressly in its justification, and/or is it a reflection of the relative strength of different constituencies?

Ari: It's not really explicit. You know, when FERC used the term, we want sort of more economic resources in the market, this is what they're talking about. So a number of entities will argue, and particularly the self-supply entities, will come and say, "well the sort of short term focus of these capacity options is not how we make resource planning decisions." When we invest in a new power plant, we think about the long-term interests of our rate payers looking out decades in advance. That may or may not be a good model. It's tough to predict these things, but that's very different from PJM and FERC's approach, which is you're buying capacity for three years in advance, and the whole system is keyed on natural gas fired power plants.

Ari: There's another thing going on here, which is that many parties argue due to some of the technical rules, this is actually biased in favor of existing plants. And so it actually dissuades new entry in general and will actually have the effect of keeping existing plants in business longer than they might otherwise have been.

Joe: What was the impetus for this action?

Ari: So the legal, technical answer to your question is that in March of 2016 some of these merchant companies filed a complaint arguing that the PJM rules were "unjust and unreasonable." That's the phrase in federal law, that FERC's rates have to be just and reasonable because of this price suppression problem.

Joe: Okay, so the rules as they existed in March of 2016 were what the merchants were complaining about?

Ari: Yeah, the rules then, as I said, the minimum offer price rule that administratively resets generators' offers into the market was quite narrow and directed only at market power concerns.



Joe: I see, and it sounds like what the petitioners, if I can call them that, were looking for was an expansion of the screen or adjustments to the minimum offer price rule that reflected their claimed problems.

Ari: Right, and the interesting thing is how this has expanded over time. They were very narrowly focused initially on some proposals in Ohio that never forward. Then they focused on Illinois' ZECs for nuclear plants, zero emission credits that benefit nuclear plants in Illinois. Then in 2018 when PJM actually put forward a proposal, they expanded it to include other clean energy incentives like renewable portfolio standards. FERC's order goes even farther and also targets demand side programs, demand response, energy efficiency, and self-supply as well, as I've mentioned, which FERC's proposal didn't include. And now ironically some of those merchant companies that filed that initial complaint have even come back and told FERC it's gone too far.

Joe: The extent to which FERC has gone as far as it has, which sounds pretty expansive when you list the factors that trigger the application of the new rule. It's gone so far as to prompt some of the initial requesters to say it's gone too far. That raises the suspicion that there's a policy agenda, if not political agenda, that's driving the majority on the commission that's part of this rule. Is that a well-founded suspicion or have I been a political hack too long?

Ari: Yes.

Joe: Yes. I've been a political hack for too long? [laughter]

Ari: You know, I think there were proposals in the early part of this administration, a proposal to explicitly bail out coal plants as well as nuclear plants through PJM market rules that FERC ultimately rejected. You could see this as part of an extension of that. I personally think there's probably an element of that, although I think the current majority at FERC really believes that this is a pro-market agenda. I think that's totally misguided. I think they've bought into the rhetoric of these merchant generation companies, largely now privately owned companies, private equities, so we don't really know a lot about the profitability of individual investments.

Ari: So I think there's just a belief that this is the pro-market solution. Ironically though they've also included renewable energy credits that are not mandated by states. So corporations that just want to go green. And that's what a lot of groups participating in this proceeding have really objected to. Because I mean it's clear to me that the power industry is getting cleaner. I think that trend is pretty clear, and it's only going to get cleaner, not just through state policies but through commitments that utilities are making and corporations and cities, et cetera. And this order pulls it back in the opposite direction. It makes it more



expensive to go renewable and to get cleaner. So there's just a fundamental tension there which FERC historically has in a sense tried to follow trends in the industry and to facilitate those trends to encourage new technologies. And this has the effect of doing the opposite, just a complete departure of FERC's 20 plus year history of market regulation.

Joe: Well let's just leave it at there being two pieces of circumstantial evidence on the basis of which you can forgive people like me at least from being suspicious. One is what you just described, is a departure from a 20-year trend or even a 20-year trajectory of consistent practice of reinforcing trends within the sector, including the trend towards cleaner energy. And then of course the notice of proposed rulemaking that emerged, at this point 2 years ago, that explicitly sought to promote certain kinds of generation.

Ari: And if you want to throw one more in there, there's also a notice of proposed rulemaking repealing some key PURPA provisions, which is a statute that encourages or mandates a renewable energy development.

Joe: Well, that even reinforces my sense of forgiveness among those of us who are suspicious about the policy agenda, or even the ideological agenda. Why did the merchants who said this has gone too far say this has gone too far?

Ari: Because it started to interfere with their own financial interests. These are companies that engage in voluntary REC trading, renewable energy credit trading. Another company weighed in and said, Well you shouldn't apply this to demand response, which is the concept that consumers use less in response to price signals. They respond to those price signals. And because that company has a demand response business that was a new expansion of this MOPR and so they said FERC had gone too far. So you know, be careful what you unleash.

Joe: Yep. Be careful, I would say, about whom you hand the pen to. This is a pretty good segue into what you've just finished doing, which is reviewing the request for rehearing. But as sort of an overture to that this came down as a FERC order. Were there dissents?

Ari: Yeah, there was one dissent as there often is on big issues at FERC today. There's only three commissioners and Commissioner Glick had a pretty strong dissent. I would say that he hits a lot of the key themes that the re-hearing requests hit as well. The first issue is the argument that FERC is encroaching on state authority. There's two components to this argument.

Ari: One is that states have authority over generation facilities and the utility portfolios that meet consumer demand. And the second piece is that states also clearly have authority over environmental policies. So policies to price emissions



or to value clean energy. states have characterized those as environmental policies. The effect of all this is to nullify those state policies, so that encroaches on state authority both under the federal power act and just under state's inherent police power to improve the health, safety and welfare of their residents.

Joe: Based on reading your tweet thread of an hour or so before we recorded this, it sounds like a number of states really echoed and amplified that point.

Ari: Yeah, I mean the states that have clean energy policies are the ones that are particularly strong on this. New Jersey BPU has an excellent filing. Maryland Public Service Commission. West Virginia as well, and that's a different kind of case. West Virginia doesn't have any clean energy policies. What West Virginia does have is a hundred year old regulatory model where vertically integrated utilities own all the power plants and plan new power plants pursuant to state supervision. So that's one of these self-supply entities that gets caught up in this, and they are. You look, West Virginia hasn't done anything new in a hundred years yet still somehow the regulatory construct is now massively changing even though we haven't changed at all.

Joe: Speaking of New Jersey BPU, I can't resist the temptation to quote a fabulous piece of comment, rhetoric, NJBPU wrote, "Forcing a state to fundamentally alter its regulatory framework to avoid the bite of a rabid MOPR is hardly a viable solution." I know you spend a lot of time reading comments as do I. But every once in a while really rewarding-

Ari: There's some real gems in there.

Joe: ... For us comment readers to see rhetoric.

Ari: Yeah. And a number from New Jersey. I should just take a step back and just talk about the process here. Once FERC issues in order, parties have 30 days to file a rehearing request that lay out all their objections. So about 50 filings came in this week. FERC then has to rule on those re-hearing requests before anyone can file litigation in federal court. FERC's practice has been to sit on re-hearing requests for as long as two years, even more. That essentially blocks anyone from going to federal court. I suspect that's what will happen here, but we'll see how that plays out. So we could be years away from anyone even being able to file anything in federal court.

Ari: An alternative way that this plays out is that, I don't know if you know we have an election this November, and FERC might go from being majority Republican to majority Democrats sometime in early 2021. Particularly if there's been no rehearing order issued, the new FERC commissioners could potentially actually



grant re-hearing and reverse themselves on this order, which is pretty rare particularly for a major order like this but is legally possible. So then we would never litigate in federal court because FERC might just undo this decision. Of course, the other way that this could play out is that we don't have a new FERC. FERC issues the three hearing order. We litigate this sometime in like 2022 or something, or '23, and then we'll see what the court does. But in the meantime there'll be a lot of auctions under which these rules will presumably be in effect.

Joe: In your experience is this the sort of thing that Congress might involve itself in. I'm thinking particularly that the House Energy and Commerce Committee is now chaired by Frank Pallone from New Jersey. Is there anything that comes to mind in first impression where other than an oversight hearing Congress could or would be inclined to do anything about this?

Ari: Probably not. I mean there is definitely interest, even in the Senate which you know as of now is still Republican. But when FERC nominees go in for their confirmation hearings there is some interest from Republican senators about state's rights issues and how FERC regulation will affect state's rights. My guess is and I'd have to look at a map on this to see what the overlap is between Republican senators and PJM states that are most directly affected by this. This sort of interest sometimes comes from Republican senators who aren't even in these sorts of markets at all. So anyways, it seems possible but again, there's an election in November.

Joe: Right. Right. Are there any other sort of key issues that were raised either by Commissioner Glick or any of the requests for rehearing?

Ari: Yeah, so just to mention, another big objection is that there are various parts of this order that are arbitrary and capricious, right? And that's this administrative law term for when an agency changes its policy without explaining, for when it ignores the evidence, doesn't respond to comments, or just does something that's illogical. And this is such a major change in FERC policy that it's fertile ground for parties raising these arbitrary and capricious arguments. So there's both changes in major policy things, like as I mentioned, the self-supply exemption, including demand response in the MOPR, divorcing prices from reliability. These are major policy changes that FERC either pretends aren't happening or just in a couple of lines brushes aside, despite the fact that there is voluminous evidence in the records submitted by parties about these issues that FERC simply just doesn't engage with. Whenever an agency tries to do something this big it's going to open itself up to these kinds of challenges.

Joe: In the vein of whether or not any of the requesters for re-hearing and presumably eventual federal court litigants being stymied by FERC sitting on



these requests for two years. Is there any other recourse that people objecting to this action might have?

Ari: Well, I should mention one thing first, is that there's currently a case in the DC circuit, which is hearing the case en banc, which rarely happens, about FERC's practice of sitting on these re-hearing orders. But it's specifically in the context of the natural gas act and FERC's approval of pipelines, and that has consequences for private property being taken away by pipeline developers before the appeal can be heard. So there may be some ways to distinguish what FERC does on the Natural Gas Act and the Federal Power Act, but it's possible a court will tell FERC to stop doing this. That's something that might happen in the spring or summer.

Ari: Apart from that, FERC has issued this order and it's given PJM 90 days to come back with a compliance filing, sort of the specific tariff language to actually implement all of this. So it'll be interesting to see how PJM interprets FERC's order. In fact, PJM is actually one entity that filed a re-hearing request saying FERC had gone too far in a number of respects. So it'll be interesting to see what they say. That process has to play out at FERC as well. So it's possible that some of the things that FERC has said in the order may get slightly tweaked in this compliance process.

Ari: The one other thing that's happening right now is that the Illinois Attorney General had filed a lawsuit immediately after this order was issued. It was going to make sort of due process arguments because this order was proceeded by an order in June, 2018 that found the then existing rules unjust and unreasonable. FERC in this December order doubled down on numerous conclusions from that prior order, but it never put those magic words in "We are denying re-hearing of that prior order." So effectively it's continuing this practice of sitting on these old orders preventing anyone from going to federal court, and the Illinois AG has gone to federal court and is going to call FERC out on this and demand that it be able to litigate this prior determination about whether the original rules were unjust and unreasonable.

Joe: One little piece-

Ari: I should say one more thing.

Joe: Go ahead. Say it.

Ari: One big issue in this proceeding was whether or not individual clean energy resources could opt out of the capacity construct and take with them an equivalent amount of demand. This would have the effect of shrinking the overall size of the capacity market and would eliminate this problem of rate



payers paying twice that we talked about earlier. FERC dismissed that alternative in about one line. Again, this is another arbitrary and capricious problem. But there is an existing option in the tariff for a utility to entirely depart the capacity auction. So it could have its own set of contracts outside the capacity auction and then wouldn't have to buy anything from it. So we're seeing legislation right now in Illinois that would set up this option for the Illinois utility that participates in PJM, and that could allow it to procure capacity from clean energy resources, not have to buy anything from PJM. And so we might see this play out in a few states that have aggressive clean energy targets, or potentially Virginia which is mostly self-supply.

Joe: So the objectors could remedy their problem to some extent with their feet by taking a route outside of this. So this order essentially alters the rules by which upcoming capacity auctions will be conducted. Going back to what you said about the compliance or the implementation step, when's the next scheduled PJM auction? Will this rule with this new order govern that auction? And is there any recourse that states or clean energy generators would have with respect to that auction, within the context of that auction, to evade or mute the effect of this change?

Ari: So we don't know when the next auction is. Typically PJM holds these auctions every May. Last May's auction was delayed because this sort of limbo about the rules where FERC had already said they were unjust and unreasonable but hadn't said what the new rules were going to be. So they delayed the auction. Best case scenario from the merchant companies that want this auction as soon as possible is probably the end of this year. Some state entities are calling for delay well into 2021 so they can have some time to figure out alternatives. So delay is good for clean energy advocates so they can try to figure out ways around or getting out of the capacity auction.

Joe: This is obviously entirely speculative, but I'm wondering if there's going to be a disruption of PJM and the PJM auction mechanism that's far greater in its effect than either the merchant petitioners or the commission itself bargain for.

Ari: Yeah, sure. That's the conspiracy theory version of what the FERC majority is doing here, is in fact they don't like capacity auctions. They're a highly criticized device at ensuring resource adequacy and in fact they went so far, they know that their result is going to be it's unraveling as states start to exit and that just collapses the market.

Joe: Wow. That's a conspiracy theory I wasn't familiar with. I feel deprived. Thank you for catching me up. I assume you use the term conspiracy theory by way of expressing some skepticism as to whether that's the real agenda.



Ari: There is no evidence for it so that's why it's a conspiracy theory. But it very well could be the effect and then this all would have really backfired on those merchant generation companies. But presumably if the capacity auction goes away, it'll have to be replaced by something. So the Texas market is the example of one of these centrally operated energy markets that doesn't have a capacity auction. It has different rules in its energy market and it just uses that to ensure that it has enough resources to keep the lights on. Every summer folks get nervous about it when it gets hot in Texas and demand goes up, and so far so good.

Joe: Anything else that people who are listening to this would want to, or should, be aware of?

Ari: The changes FERC ordered to the capacity auction are not necessary to keep the lights on. PJM has more than enough capacity and that's not expected to change anytime soon. So to the extent that the auction rules had any problem, they were purely theoretical, and FERC ignored here the practical effects of its decision. The expanded MOPR that FERC ordered is going to raise prices without providing consumers with any benefits, and therefore it fails the most basic test for just and reasonable rates which seven years ago the Supreme Court said have to balance consumer and investor interests. The only beneficiaries here are private equity investors, and fossil fuel-powered plants, and deluded economists who have convinced themselves that an auction where demand is set administratively or supply has to offer at preset prices, and where the only product doesn't reflect consumer preferences, is somehow a market, and doubling down on administrative interventions is somehow good for competition.

Ari: I also want to reiterate that this decision pulls the industry back in the opposite direction of where it's headed. Clean energy is the future of the power sector, and this order makes clean energy more expensive and more burdensome to develop. So I think ultimately one way or another, this order is not going to survive the test.

Joe: An interesting, and perhaps even a hopeful, way to end this discussion. Thank you very much, Ari. I know you've been killing yourself to digest, analyze, and write about this order, and then in the last 24 or 48 hours to digest all the requests for a re-hearing. And I'm sure a lot of people, even before this podcast gets posted, will be benefiting from your usual great work.

Ari: Thanks Joe.

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