Public Power Weekly Exclusive: FERC's Clark discusses market enforcement approaches in interview

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FERC Commissioner Tony Clark

Tony Clark, a commissioner at the Federal Energy Regulatory Commission, in a recent interview with the American Public Power Association's news department, offered his thoughts on several issues including, among other things, FERC market enforcement, regional transmission organizations and capacity markets and the question of whether he has a preference for either a vertically-integrated or fully restructured model.

[The following story is the second of two articles based on Clark's responses to questions during the interview, which took place at the commissioner's offices at FERC headquarters in Washington, DC, on Feb. 23, 2015. The first story, which was published in the March 9 issue of Public Power Weekly, focused on the country's energy infrastructure, Clark's initial thoughts on FERC's technical conferences examining the U.S. Environmental Protection Agency's Clean Power Plan and where he thinks the line should be drawn between federal and state jurisdictions when it comes to energy markets].

Approaches to market enforcement

In the interview, Clark elaborated on his views related to rules-based and principles-based approaches to market enforcement.

In an article, "Ensuring Reliability and a Fair Energy Marketplace," which was an adaptation of an October 2013 speech given by Clark, Clark and Robin Meidhof, a legal and policy advisor for Clark, wrote about FERC's approach to market enforcement and, more specifically, principles-based and rules-based approaches to enforcement.

"By administering principles-based enforcement, FERC is able to protect the energy markets from all types of fraudulent behavior," the article stated. "A finding of fraud requires either a judgment as to whether a misrepresentation was made or a certain practice occurred with fraudulent intent or direct evidence of that fraudulent intent. For this reason, a regulator like FERC cannot possibly create an all-inclusive list of prohibited activities."

The article said that there "simply is no exhaustive or comprehensive rulebook of all possible scenarios that would result in violations of our anti-manipulation rule—so market participants, shareholders, and regulators must rely on the use of judgment."

The article also noted that while "some would demand that a regulatory agency have the prescience to include in a rate schedule all specific misconduct in which a particular market participant could conceivably engage, that standard is unrealistic. It would render regulatory agencies impotent to address newly conceived misconduct and allow them only to pursue last year's misconduct—essentially, to continually fight the last fraud and deny the capability to fight the present or next one."

In the context of fraud, "specific regulations cannot begin to cover all of the infinite variety of cases to which they may apply, and by requiring regulations to be too specific the regulators and courts would be opening up large loopholes allowing conduct that should be regulated to escape regulation."

Because there is no single method by which fraud is best detected, "manipulation or fraud enforcement is intensely fact specific. And the absence of a list of specific prohibited activities does not lessen the reach of FERC's anti-manipulation rule, nor does it mean that FERC enforcers are making up the rules as they go along."

In the interview, Clark said that FERC, "like so many other areas of enforcement authority through government has both principles-based enforcement, but also rules-based enforcement."

He said that there are "some people who will argue that the only thing that FERC should do is a very strict, rules-based enforcement, where you define everything with great specificity in a tariff and say, this is what you can't do, and then they would argue" that FERC should "only be able to enforce that."

"I would argue [that] it can't work like that," Clark said. "That we actually have both principles-based and rules-based enforcement."

He said there are "certain things that are just very definitively described in a tariff that you can't do."

But when it comes to things like fraud or market manipulation, "You can't define every potential way someone could defraud the market. You can't define every possible way that someone could manipulate an energy market," he said.

It is FERC's responsibility "to lay out with as much specificity as possible, what are the types of activities that look like fraud, that look like market manipulation. I think we've begun doing that through a series of cases and through some of the precedent that we've had for more than a decade now."

He used the analogy of getting behind the wheel of a car and driving to further illustrate his points. "All of us who get in a car" are familiar with the concept of both principles-based enforcement and rules-based enforcement, Clark said. "When you drive a car, there are certain things that are just straight rules" that you can't violate. "The speed limit is what the speed limit is."

But there are other concepts "that are a little bit more nebulous," he said, citing reckless driving as an example. "You can be flagged for reckless driving, but there's nowhere in the book that describes every potential way you could recklessly drive. Rather, it's a set of facts that the police officer assigns to that circumstance and takes into consideration things like, what were the conditions like, were there other people around, is anyone potentially going to be harmed, how congested was the roadway at that time." So there are "all sorts of things that go into that and I think most of us have a pretty good idea what reckless driving is," but there is "not a specific list" of everything that constitutes reckless driving, the commissioner went on to say. "It's situational."

So the police officer – "in this case, FERC is like the police officer of the energy markets -- makes a call. If people who are subject to the civil fine under that call disagree with it, they can go to a judge and explain why" they don't think that the facts meet this circumstance.

If FERC "were to adopt a strict reading" under which only rules-based enforcement is to be allowed, "effectively it would be the commission adopting what I'd call a one free bite at the apple theory of market manipulation, which is – as long as you can come up with a novel way of manipulating the market, you get one free bite at it until the commission finds it and then it would be very specifically defined in a rule" and then "you couldn't do that from there on out." Clark said he "can't imagine that's what Congress was envisioning when they gave the commission the authority that it did" under the Energy Policy Act of 2005.

RTOs and capacity markets

Another area Clark addressed during the interview was regional transmission organizations (RTOs). There has been some opposition to RTO implementation from regions outside of existing RTOs. Clark was asked what, if anything, he thinks that opposition says about the performance of the existing RTOs, and, in particular, the RTO-operated capacity markets.

"I think it says that every region's a little bit different," the FERC commissioner said. "It should caution the commission to not try to force capacity markets down every situation."

He said that "coming from where I did, I didn't have a capacity market background as a Midwest commissioner. There's a resource adequacy construct in the Midwest, but it's not a capacity market."

Clark said that when he arrived at FERC "two and a half years ago, one of the things that I really delved into is trying to figure out these capacity markets and one of the things that I pretty quickly came to the conclusion of is that they're not appropriate for all situations."

He said that "there can be a case that can be made for capacity markets if you're in a region which is predominantly restructured and you have" a merchant fleet "that can only get their money through the market."

Clark said that "I'm not ready to completely throw them out and say there's never a case for a capacity market." But he also said that "the value of a capacity market lessens greatly, depending on the circumstances of a particular region." He said that "if you're in a region" that is predominantly more traditionally regulated and has vertically-integrated utilities, "the need for a capacity market really declines pretty rapidly."

Those utilities are "getting those fixed costs for that capacity" through their ratepayers, he noted. "If you're public, it's being planned in coordination with your oversight committee, the mayor, or the town council or the utility board. If you're an investor-owned utility, it's being done in coordination with your state utility commission," so "you probably just don't need a capacity market, like you would potentially in some other areas of the country," the commissioner said.

"So I think what it argues is if FERC wants markets to expand and has an interest in making RTOs as a potentially attractive option for consumers, then it needs to understand that certain regions are different and not mandate capacity markets wherever they are because that will chase a lot of utility players out of even the possibility of entertaining entering into an RTO or some sort of market," he said.

Clark offers thoughts on restructured, vertically-integrated utility regulatory models

Meanwhile, Clark in the interview also discussed a letter that he sent to Sen. Jeanne Shaheen (D-New Hampshire) in October 2014.

In his letter, Clark highlighted what he called a "lack of adequate infrastructure" in New England, but he also said that he was concerned that "there is a deeper flaw in the existing electricity regulatory regimes in place throughout the Northeastern United States." He told Shaheen that the region has "overwhelmingly restructured" the regulation of its electricity industry. "In so doing, the region relies on a merchant generation fleet that is dependent on functioning wholesale markets to provide accurate price signals," wrote Clark. These market signals, he said, are used by existing generators to decide whether to continue operations and further invest in existing units.

"Developers also depend on accurate prices to determine where, when, and what kind of resources to build," Clark wrote in the letter. "By virtue of the Federal Power Act, these wholesale markets are under the purview of FERC. At the same time I note that many of the states in the region also still engage in some degree of central planning of their utilities' resource mixes just as is done in traditionally regulated states."

Clark told Shaheen that he is concerned that this model "is unworkable and unsustainable." He believes "either an 'all-in' restructured model or a traditional, vertically-integrated utility regulatory model can work for the benefit of consumers. The experiences of places as diverse as ERCOT (Electric Reliability Council of Texas), the Southeast, the Midwest and the West would seem to bear this out."

Clark was asked in the interview whether he has a preference for either a vertically-integrated or fully restructured model.

"I think we're all products of probably where we came from and in my case, my state and my region is a very much predominantly vertically integrated region of the country, so it's what I'm most comfortable with, it's what I know best," Clark said. Clark formerly served as a member of the North Dakota Public Service Commission (PSC), most recently as chairman of that commission.

"I would say this, however – I think either system can work," he added. "There's just a set of incentives that's built into whatever regulatory model that you pick."

Clark said that his "comment in the Shaheen letter, which is something I've spoken about at some length at different events and conferences that I've been at, was just that you can have a market system that works fairly well. You can have a vertically-integrated sort of traditional structure, which I think can work quite well."

Where things can get problematic, he said, are in situations where "nominally, a state may have chosen to restructure, so they've created a merchant fleet, which is wholly dependent on the signals that it gets from the marketplace -- it doesn't have a captive rate base," but that same state wants "to retain certain things that look an awful lot like traditional, old integrated resource planning, where you're picking and choosing which generation resources you want."

Clark said "if you still want to select which generation sources get chosen, but also have a restructured environment where you have a merchant fleet dependent on market signals, that system doesn't work very well at all. You end up with probably higher prices than you would otherwise have. You end up with a merchant generation fleet that really, economically, can't make it because they're being undercut by other choices that are being made. You decrease investor confidence in the entire model, so it's tough to attract capital to that sort of system and I worry that there are certain parts of the country where that's becoming more commonplace."

When asked whether he thinks the situation has gotten to the point where FERC might want to formally take a look at it, Clark said that while FERC "has to deal with the implications of some of it," it is also "not something that FERC can go in unilaterally" to correct. "It is a state's choice for how they want to structure their regulation within their purview. So I think it's more of a situation where in those regions of the country where we're having this rub – and some of the eastern markets are probably the best example – we just need to make sure as FERC we're working very closely with the states to try to make it work as well as it can."

He said that "sometimes it may be states on their own realizing that they may need to take a step back from certain policies. Sometimes it might mean that FERC needs to be flexible in how it's dealing with the markets. So I don't know if there's one right answer to it, and neither jurisdiction" has the "total ability to fix it, but I think it requires a lot of communication between the two of us."

Clark also was asked to comment on whether he thinks a fully restructured model would impede or assist in implementation of the EPA's Clean Power Plan, which is intended to reduce carbon dioxide emissions from existing power plants.

While noting that he is "not a big fan of carbon taxes, carbon adders, carbon costs," Clark said that if "you're truly in a fully restructured model it's tough to see how the Clean Power Plan could envision anything but" a Regional Greenhouse Gas Initiative (RGGI)-type compliance. "Because if you're talking about regulating individual plants" and creating "what's effectively what some people have called a carbon integrated resource plan, but you're committed to a restructured model, I don't know how those two work."

He said that "if you're seeking to do an integrated resource plan, but imposing it on a set of generators" that don't have guaranteed cost recovery and "don't have a captive rate base, it seems to me very tricky to try to coordinate that kind of math. Whereas if they just add a carbon tax or have a carbon adder on it…and they're allowed to just bid those costs into the market and then the markets run and do what they do, it's easier to see how that functions."

Clark said that "I think that that's in some ways the EPA's big hope," that "these regions of the country will just kind of all agree to do something like RGGI, which the Clean Power Plan pretty clearly envisions, but I don't think a lot of regions of the country are going to do that. I think the regions that have adopted the RGGI type model are there already and those that haven't probably aren't going to do it, but for restructured markets it's easy to see that if you don't go that path, that it becomes complicated very quickly to figure out how you put together" a state implementation plan.

RGGI is a cooperative effort among the states of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island, and Vermont to cap and reduce carbon dioxide emissions from the power sector.