

**Summary of Testimony of J. Arnold Quinn
Director, Office of Energy Policy and Innovation
Federal Energy Regulatory Commission
Before the Committee on Energy and Commerce
Subcommittee on Energy and Power
United States House of Representatives
June 3, 2015**

Summary

Chairman Whitfield, Ranking Member Rush, and Members of the Subcommittee, thank you for the opportunity to appear before you today. My testimony will focus on those parts of the Discussion Draft that require reporting and planning to improve wholesale electricity markets (Section 4221) and establish an Office of Compliance Assistance (Section 4211).

The Commission is in the process of exploring many of the issues identified in the criteria articulated in section 4221 of the Discussion Draft. Further Commission action on these or other criteria articulated in section 4221 of the Discussion Draft prior to the enactment of the Act may diminish the need for or benefit of Congressional direction for RTOs and ISOs to address those issues. The process Section 4221 requires is somewhat similar to the process the Commission has used to develop new market rules as system needs evolve. Such a process allows each ISO or RTO and its stakeholders to describe whether and how market rules address an identified concern or system need in a manner reflective of regional differences. If Congress directs the Commission to take action beyond what it is currently pursuing, it would be useful to clarify that Section 4221 of the Discussion Draft would require a process that is consistent with existing Commission processes under sections 205 and 206 of the Federal Power Act

Further, the Commission prefers to focus on the services and performance quality that the electric power system needs and establish market rules that ensure the cost effective provision of those services at the required level of performance. While the Commission recognizes the need to encourage an adequate supply of resources that provide operational characteristics that are responsive to system needs, some criteria in section 4221 may unduly impair the competitive aspects of these markets, to the ultimate detriment of consumers, or may cause unnecessary conflicts between federal and state regulatory efforts.

In light of the Commission's mission and existing practices, it appears that Section 4211 could create duplicative proceedings for consumers and regulated entities. An Office of Compliance Assistance within the Commission that is meant to be independent from the rest of the Commission's staff could undermine the current coordination among Commission Offices and impede the Commission's ability to fulfill its mission. Finally, although Commission staff currently endeavors to provide timely guidance in response to inquiries on compliance matters, the information gathering and analysis necessary to provide the compliance guidance makes doing so in real-time challenging in virtually all circumstances.

The Commission is always looking for ways to improve the efficiency, transparency, and competitiveness of its markets, but it is important to recognize the duplication of effort and potential unintended consequences that could result from this proposed legislation.

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Introduction

Thank you for this opportunity to appear before you to discuss the potential avenues to improve wholesale electricity markets and compliance with market rules. My name is J. Arnold Quinn. I am the Director of the Office of Energy Policy and Innovation at the Federal Energy Regulatory Commission (FERC or Commission). I am here today as a Commission staff witness, and my remarks do not necessarily represent the views of the Commission or any individual Commissioner.

My testimony will focus on those parts of the draft legislation that require reporting and planning to evaluate and improve wholesale electricity markets (Section 4221) and establish an Office of Compliance Assistance (Section 4211).

Background

The Federal Power Act requires the Commission to review market rules to ensure those rules are just and reasonable and not unduly discriminatory or preferential. Market rules have evolved over time to adjust to myriad changes and the electric power system needs that accompany those changes. We have seen significant changes in technology, relative fuel costs, load growth, and state and federal laws and regulations in the time since organized wholesale electricity markets were first started. These changes affect each region of the country differently and the Commission has endeavored to allow markets to evolve to address unique regional needs while taking generic action when it is warranted. As system needs evolve, the Commission has

consistently sought to establish market rules that transparently value service to meet system needs and allow all technologies and business models to compete on a level playing field.

Fostering competitive forces in a dynamic environment requires providing market participants with the means to manage the risk associated with their own decisions instead of requiring market operators to pick in advance specific technologies or resources to manage expected system needs. Congress has taken a number of steps to facilitate competition in wholesale electric markets. The Energy Policy Act of 1992 and the Energy Policy Act of 2005 promoted competition by lowering entry barriers and increasing transmission access. The Commission has stated that marketplace competition benefits energy consumers by encouraging diverse resources, spurring innovation and deployment of new technologies, improving operating performance, and exerting downward pressure on costs. In short, the Commission prefers to rely on competitive forces when reasonable, but recognizes that traditional regulatory requirements are sometimes necessary in wholesale electricity markets.

Evaluating and Improving Wholesale Electricity Markets

Section 4221 of the draft legislation would require the Commission to direct Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs) to provide a report to the Commission that details how and whether existing market rules address criteria articulated in the Discussion Draft. This section also requires the ISOs and RTOs to provide a specific action plan with an implementation timeline to adopt market rule changes to address any criteria not addressed by current market rules.

The Commission is in the process of exploring many of the issues identified in the criteria articulated in section 4221 of the Discussion Draft. For example, the Commission recently described its concerns regarding a broad set of issues with respect to generator access to sufficient fuel supplies and the firmness of generator fuel arrangements. The Commission

referred to this broad concept as “fuel assurance” and noted that it includes a range of generator-specific and system-wide issues, with recognition that certain issues may have a regional element to them. Similarly, the Commission and its staff have been engaged for more than a year in an effort to better understand price formation in organized wholesale energy markets. This effort has included four staff papers and three technical conferences that covered a wide range of issues and extensive interaction with a wide variety of industry stakeholders. Finally, the Commission has taken a number of actions over the last three years to address the need for better coordination between the natural gas and electric industry. To the extent the Commission takes further action on these or other criteria articulated in section 4221 of the Discussion Draft prior to the enactment of the Act, that action may diminish the need for or benefit of Congressional direction for RTOs and ISOs to address those issues.

As a general matter, the Commission prefers to focus on the services and performance quality that the system needs and establish market rules that ensure the cost effective provision of those services at the required level of performance. Some elements of the Discussion Draft would require intervention into markets to place a value on a specific class of resources (e.g., resources that can operate on a continuous basis for an extended period) or a diversity of fuel-types rather than allowing the market participants to drive the appropriate valuation of an identified system need. While the Commission recognizes the need to encourage an adequate supply of resources that provide operational characteristics that are responsive to system needs, these elements in section 4221 may unduly impair the competitive aspects of these markets, to the ultimate detriment of consumers.

Some elements of section 4221 may also cause unnecessary conflicts between federal and state regulatory efforts. For example, section 4221 would require RTO and ISO markets to

“facilitate fuel diversity” and “identify and address ... market-distorting incentives.” The Commission and states may differ on the proper components of each fuel in the generation portfolio. Further, some states may assert that what an ISO or RTO deems to be a “market-distorting incentive” is in fact a legitimate policy adopted by a state to meet its specific policy needs. Similarly, regulators may differ on which facilities can generate “during emergency and severe weather conditions,” since this phrase may or may not include drought-prone hydropower facilities; coal facilities dependent on winter-impaired deliveries of coal by rail or barge; or natural gas facilities affected by wellhead freeze-offs.

The process required under Section 4221 of the Discussion Draft is somewhat similar to the process the Commission has used to develop new market rules in the face of evolving system needs. On several occasions, most recently on the issue of fuel assurance, the Commission has identified a specific issue with how market rules are functioning and required ISOs and RTOs to report to the Commission how they are addressing the identified concern. One benefit of such a process is that it allows each ISO or RTO and its stakeholders to describe whether and how market rules address an identified concern or system need in a manner reflective of regional differences. When the Commission has taken such action, it has done so to gather information in an effort to inform what could become an action under section 206 of the Federal Power Act. The Commission would institute a proceeding under section 206 of the Federal Power Act only after making a determination that an ISO or RTO’s market rules may have become unjust and unreasonable and/or unduly discriminatory or preferential.

If Congress directs the Commission to take action beyond what the Commission is currently pursuing, it would be useful to clarify that Section 4221 of the Discussion Draft would require a process in which each ISO and RTO would examine the specified criteria and present

its findings to the Commission, on an informational basis, in the form of an action plan with an implementation timeline to adopt market rule changes to address any criteria not addressed by current market rules. Building on that foundation, each ISO or RTO then could propose specific market rule changes to the Commission, in accordance with that timeline and pursuant to section 205 of the Federal Power Act. Alternatively, the Commission could use that foundation as a basis to institute proceedings under section 206 of the Federal Power Act. As currently drafted, it is not entirely clear how the submittals required under Section 4221 of the Discussion Draft relate to those important provisions of the Federal Power Act.

Office of Compliance Assistance

Section 4211 of the Discussion Draft would establish an Office of Compliance Assistance. This Office would seek to promote improved compliance with the Commission rules and orders in several ways: make recommendations, issue reports and guidance, and conduct outreach. While I support the goal of this section, I believe that the Commission, the Offices within the Commission and the Commission staff are currently and actively performing much of the work envisioned by this section.

The Commission's mission is to protect the Nation's energy customers by fostering energy markets that produce just and reasonable rates, effectively enforcing both market and reliability rules, and promoting development of needed energy infrastructure. In carrying out those responsibilities through appropriate regulatory and market means, the Commission assists consumers to obtain reliable and efficient energy services at a reasonable cost. The Commission also is committed to procedures that provide interested parties, including consumers and regulated entities, with both opportunities to provide input to the Commission and explanations of the Commission's actions.

On cases pending before the Commission, the Commission has detailed notice and comment procedures to ensure it has an adequate record prior to making a decision. The Commission also examines and applies, as appropriate, the relevant existing Commission rules and precedent to the issues before the Commission. The Commission works to ensure that market rules recognize regional differences where necessary but applies the underlying legal, economic and reliability framework in a consistent manner.

The Commission can use a range of strategies to ensure that interested parties have an appropriate opportunity to inform our decision-making when it wants to explore changes to its energy policies, identifies potential enhancements to market design and rules, proposes new initiatives, or considers potential improvements to industry and Commission practices. The strategies implemented by the Commission and/or its staff include: holding public meetings and conferences; conducting frequent outreach; issuing for public comment draft documents, such as white papers, reports, proposed rulemakings and policy statements; seeking and thoroughly considering public comments in response to Commission or staff actions; and participating in collaboratives with our state colleagues. State commissions, state consumer advocates, and state attorneys general are active in our proceedings and provide valuable input in our decision making. The Commission and its staff constantly strive to balance the different interests, including weighing the necessity of policy changes against providing regulatory certainty.

Among numerous recent examples, I will mention the Commission's recent efforts on fuel assurance. Those efforts resulted from two public technical conferences, one on capacity market design and another on lessons learned during extreme winter weather in 2014 (Polar Vortex). Following both conferences the Commission sought written comments. Based on the comments and the discussion at the technical conferences, the Commission issued an Order on

Technical Conferences that described the Commission's concerns about fuel assurance and required reports from the ISOs and RTOs on what they were doing to address fuel assurance concerns. Finally, the Commission accepted public comments on the ISO and RTO reports.

The Commission's efforts to identify enhancements to market design or consider potential improvements to industry and Commission practices involve a multi-disciplinary team of policy experts, attorneys, economists and engineers that come from multiple Offices within the Commission. These cross-office teams provide a range of perspectives as they analyze the information gathered and received, to craft options for the Commission's consideration.

Market participants have multiple ways to seek guidance on compliance with market rules and the Commission's anti-manipulation rules. Informal guidance is provided through the Compliance Help Desk and meetings and discussions with individual members of Commission staff. No Action Letter responses, legal opinions issued by the Office of the General Counsel, and interpretative letters issued by the Chief Accountant provide written guidance from Commission staff. While not binding on the Commission, these advisory materials provide confirmation of staff positions that reflect various levels of staff consensus.

In light of these existing practices, it appears that Section 4211 could create duplicative proceedings for consumers and regulated entities. To the extent Section 4211 envisions an Office of Compliance Assistance within the Commission that is meant to be independent from the rest of the Commission's staff, such a development also could undermine the current coordination among Commission Offices and impede the Commission's ability to fulfill its mission.

Further, several elements of section 4211 in the Discussion Draft could contribute to confusion rather than increasing clarity on compliance with the Commission's requirements. For

instance, section 4211 of the draft legislation would require the Office of Compliance Assistance to provide real-time compliance guidance. Any guidance that staff provides must be based on the factual basis provided. Further, staff frequently need to discuss a situation with the market operator to understand better the practical implication of any requested guidance. In addition, staff would likely need to review all relevant tariff provisions and associated Commission orders. Thus, although Commission staff currently endeavors to provide timely guidance in response to inquiries on compliance matters, the information gathering and analysis necessary to provide the compliance guidance makes doing so in real-time challenging in virtually all circumstances.

I would also note that the Federal Power Act already contains a provision for an Office of Public Participation within the Commission. However, that provision, which was added in 1978, has never received funding from Congress.

Conclusion

The continued improvement in wholesale electricity markets is of importance to the Commission. Thank you for inviting me to testify today on the Discussion Draft. I look forward to working with you in the future on these issues and would be happy to answer any questions you may have.