UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

State Policies and Wholesale Markets Operated by ISO New England, Inc., New York Independent System Operator, Inc., and PJM Interconnection, L.L.C.	))))	**Docket No. AD17-11-000**

PRE-TECHNICAL CONFERENCE COMMENTS
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Dynegy Inc. ("Dynegy") appreciates the opportunity to participate in the Commission's technical conference on this important topic. In advance of the conference, I address the questions posed by Commission Staff in the Supplemental Notice issued in this docket on April 13, 2017.

1. Should the Commission distinguish between state actions that are considered inside the market and ones that are out of market, and why? How can certain types of state policies be readily integrated into wholesale markets as opposed to pursuing state policies outside of the centralized energy and capacity markets?

As the Supreme Court recently noted in *Hughes v. Talen,* a state cannot regulate in a domain Congress assigned to FERC and then require FERC to accommodate the state's intrusion.[1] FERC should not have to accommodate state policies that are "targeted" or "aimed directly at" the FERC-jurisdictional wholesale markets. Nevertheless, there has been a recent proliferation of exactly this sort of state action. The Illinois and New York Zero Emissions Credit ("ZEC") programs are examples of state actions that are preempted because the state is acting in area reserved to FERC, and doing so in a way that conflicts with Commission policy. These programs pay market participants directly for producing electricity from units that were otherwise retiring and artificially suppress capacity and energy prices for the balance of the market participants, as recently demonstrated in the 2017-18 MISO Planning Resource Auction ("PRA" or "capacity auction"). By impacting the FERC-jurisdictional wholesale energy and capacity markets in this way, the state programs interfere with proper price formation and distort market participant incentives. Impacted market participants, including Dynegy, have asked the federal courts to find these state actions are preempted, but time is of the essence as these impermissible state actions are already directly impacting the wholesale markets. As the courts consider these challenges, FERC should act in parallel to put rules in place that protect the wholesale markets and market design to ensure that state actions do not impact the interstate pricing of energy and capacity. States must bear the full cost of any subsidies they put in place.

Wholesale power markets can no longer work as-is due to interference from subsidies for certain resources. The markets were designed to provide customers with safe, reliable power at the lowest cost. Dynegy believes this should continue to be the goal of the FERC-regulated wholesale power markets. The Commission should address those state actions which compromise this objective in order to

[1] *Hughes v. Talen Energy Marketing*, 136 S. Ct. 1288 (2016), at FN 11.

neutralize the subsidy benefits bestowed by the state for certain local favored resources. FERC should alleviate the negative impacts on suppliers that depend on the competitive market for cost recovery by directing the RTO/ISOs to find a rational way to discipline subsidies.

2. For the rest of the panelists, please explain how out-of-market payments received as a result of a state policy has affected or will affect wholesale markets in general and your entity specifically.

In RTO/ISO markets, a generator relies on the combination of energy and capacity revenues to recover its costs. A generator's offer to supply energy and/or capacity is typically tied to its cost of producing the energy, but the ZECs will enable the nuclear generators to make offers well below their production costs. In fact, the Illinois ZEC program creates a perverse incentive whereby the one supplier receiving the credits – Exelon – is incented to offer capacity into the MISO capacity auction at $0, well below its cost of production. Further, because the value of the ZECs is calculated by looking to the capacity clearing prices in both MISO and PJM, the ZECs appear to incent Exelon to suppress MISO capacity prices (where it owns one subsidized generation facility) and raise PJM capacity prices (where it owns approximately 22,000 MW of generation) in order to maximize market revenues and ZEC revenues at the same time.

The Illinois subsidies led Exelon to reverse the announced retirement decision for its uneconomic 1,870 MW Quad Cities facility as well as to reverse course with respect to the anticipated retirement of its uneconomic 1,070 MW Clinton facility. Both of these actions have clear distortive effects on the capacity and energy markets in PJM and MISO, as evidenced by Exelon's decision to offer capacity from Clinton into the 2017-18 MISO PRA at $0. Dynegy, and market participants other than Exelon, will have to retire more cost-effective generating units in PJM and/or MISO that otherwise would have continued to participate in the wholesale markets absent the ZEC program and its resulting artificial suppression of wholesale market prices. Dynegy currently has eight power plants in Southern Illinois representing approximately 5,500 MW of generating capacity in the MISO market. If Exelon's Clinton facility is to be subsidized for the next ten years and therefore incented to bid into the MISO PRA at $0 for the next ten years, Dynegy's Southern Illinois fleet cannot survive. The ultimate impact of this subsidy for a single competitor is that other existing, more competitive generation will be forced out of the market and new investment will not occur in the market without a true capacity price to signal the need for investment.

Dynegy has already been negatively impacted by the Illinois subsidy to Exelon and will be impacted even more so in the future from the Illinois and New York nuclear subsidy programs absent relief from the courts or Commission action to preserve the integrity of economic price formation and the competitiveness of the wholesale energy and capacity markets. As a result of the ZECs, Dynegy's bids for our Central and Southern Illinois generation units did not clear the 2017-18 MISO PRA capacity auction and likely will not clear future auctions, including energy auctions and the upcoming PJM capacity auction. Dynegy expects to receive less revenue in auctions in which our bids do clear, because the clearing price will likely be negatively impacted by the New York and Illinois ZEC subsidies. As a result of this clear market distortion, Dynegy's strategy will have to be modified. We will be unable to proceed with planned investments, capital improvements, hiring, and will need to evaluate shutdowns of generating plants that are more cost efficient than the subsidized nuclear units. The distortion will

adversely affect our business in the states that have proposed the subsidies and beyond due to the interstate nature of most of the RTO/ISO market.

The ZEC programs will also have secondary effects for all competitive energy providers, including Dynegy. The cost of capital will increase for unsubsidized competitors and investors will lose confidence in the independent power producer business model. Independent power producers are a critical component of competitive markets. The actions of one entity in coercing states into creating the ZEC programs have put the future of all other competitive energy providers in jeopardy.

In addition to the impacts of the ZEC program on the wholesale market and wholesale market participants like Dynegy, the subsidies will provide Exelon's retail arm, Constellation, with the ability and incentive to artificially suppress Illinois retail electricity prices. This artificial price suppression will be to the detriment of other Illinois retail providers like Dynegy's Homefield Energy and Dynegy Energy Services, LLC and will ultimately harm consumers as artificial price suppression will lead retail providers other than Constellation to exit the market.

3. What wholesale market benefits may be lost when states take actions outside of these markets?

The wholesale markets were designed to provide safe, reliable electricity at the lowest cost. Prior to the inception of organized markets, consumers and regulators alike were frustrated by the shortcomings of the regulated monopoly utility model: high cost of electricity, project delays, project risks borne by consumers rather than shareholders and a general lack of innovation. A November 2016 study by The Ohio State University and Cleveland State University, sponsored by the Northeast Ohio Public Utility Council ("NOPEC"), on electricity consumer choice in Ohio explored how competition has outperformed traditional monopoly regulation.[2] The NOPEC study found that "deregulation has saved Ohio consumers $3B a year for a total of $15B over 5 years…[F]urther, the deregulated Midwestern states of Ohio, Pennsylvania and Illinois have over time outperformed their regulated Midwestern neighbors Michigan, Indiana and Wisconsin."[3]

When states take actions that harm the organized markets, many if not all of the benefits of the competitive model will be lost. The market will lose more efficient, lower cost generators and retain more expensive, less efficient generators, which will ultimately lead to higher costs for consumers. Innovation and investment are also sacrificed. State policies that preserve old, uneconomic generation interfere with an orderly transition to newer, more efficient technology, which only serves to slow down the transformation to cleaner energy as a whole. By preventing the market from working as it was designed to work and preventing the exit of uneconomic units, states are inadvertently creating a cliff event at some future point.

Furthermore, when a state subsidizes certain resources based on "favored" attributes that policy decision undervalues and places at risk attributes that other resources provide, and in the process will likely undermine reliability. The ZEC programs in New York and Illinois subsidize uneconomic nuclear plants in large part due to the job and economic impact of these facilities without fully considering the broader consequences and the overall impact on cost competitiveness.

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[2] https://marketing.nopecinfo.org/acton/attachment/18528/f-014f/1/-/-/-/-/Customer%20Choice%20White%20Paper.pdf.

[3] *Id.* at 7.

4. With the idea that state or regional policy objectives can be achieved on a long-term basis through modifications to or potentially new or different wholesale market mechanisms, what would be the elements of a policy solution that could accommodate the objectives of a state or region while preserving the competitiveness and efficiency of wholesale markets?

The current competitive model of selecting resources in the energy market based on their production cost and in the capacity market based on their longer term costs does not work in an environment where some resources receive subsidies but others must rely on market pricing for cost recovery. A hybrid approach is simply not sustainable. States must determine which goal they want to pursue: the protection of the competitive markets, or a return to a cost-of-service rate structure for all resources. States in the eastern markets have voluntarily joined FERC-jurisdictional competitive wholesale markets in order to provide the most cost-effective energy to consumers. If a state wants to change the resource mix, it can certainly choose to pursue that goal, but should also bear the full cost of that policy decision. The wholesale markets should not be impacted. Alternatively, a state can always opt-out of continued participation in an ISO/RTO. Should states elect to continue with the competitive markets, there are a number of market design safeguards that must be implemented as soon as possible.

One such safeguard is an adequate Minimum Offer Price Rule ("MOPR") in the capacity markets. FERC should require adequate minimum bids for all existing and new resources that receive revenue or revenue certainty (e.g. long term multi-year contracts, ZEC payments) from sources other than the competitive marketplace. All resources, new and existing, should be required to bid at least the level they would have bid if they were being supported solely by the competitive market.

Another potential solution that should be considered as soon as possible is an alternative clearing mechanism. In August 2016, PJM released a white paper outlining a mechanism that could be an alternative to a minimum bid in addressing buyer side mitigation.[4] Under this proposal, resources that receive subsidies would only receive payments from the regulatory authority that granted them a subsidy, instead of receiving capacity payments from PJM. They would still be considered to meet the reserve margin requirement in the capacity auctions, but they would be inserted into the supply curve at technology-specific reference price levels as proposed in PJM's whitepaper. ISO-NE also recently issued a white paper to address growing concerns over subsidies and their impact on the Forward Capacity Market ("FCM"). ISO-NE proposes a two-stage, two-settlement process to "accommodate the entry of significant subsidized resources over time while maintaining competitively-based capacity prices for non-subsidized resources."[5]

While Dynegy believes an existing unit MOPR and an alternative clearing mechanism solution are worth pursing, there must be a more organized approach going forward. Any change to organized markets should be initiated by FERC in the form of a change to the market design or market rules, rather than as a reaction to a state policy that compromises the integrity of the FERC-jurisdictional markets. Illinois and New York have been coerced into policy actions before FERC and the ISO/RTOs can create rules sufficient to preserve the integrity of the markets. FERC must exercise its authority to ensure a more orderly path forward.

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[4] http://www.pjm.com/~/media/committees-groups/stakeholder-meetings/grid-2020-focus-on-public-policy-market-efficiency/meeting-materials/20160816-potential-alt-solution-to-the-min-offer-price-rule-for-existing-resources.ashx

[5] ISO-NE Memo, Competitive Auctions with Subsidized Policy Resources, April 17, 2017. Available at: https://www.iso-ne.com/static-assets/documents/2017/04/iso_caspr_highlights_april_2017.pdf.

5. If state policy objectives cannot be achieved through the wholesale markets, what are the consequences for the wholesale markets, as well as for market participants' ability to make long-term decisions, of continued state support for certain resources or resource types outside wholesale markets?

If the states do not believe that the organized markets are meeting their objectives, they can take actions to achieve those objectives. However, the states must also be accountable for the full cost of these actions. As previously noted, one of the foundational premises of the competitive markets was to shift investment risk from consumers to private investors. Recent state-level interventions have had a devastating effect on the ability of unsubsidized market participants to attract and retain private capital. Investors see little or no future in the competitive power producer model given the current deluge of out of market subsidies, which effectively carve out market share if not destroy the competitive markets altogether.

Secretary of Energy Rick Perry recently directed Department of Energy Staff to conduct a study examining energy markets and reliability, noting that "analysts have thoroughly documented the market-distorting effects of federal subsidies that boost one form of energy at the expense of others. Those subsidies create acute and chronic problems for maintaining adequate baseload generation and have impacted reliable generators of all types."[6] Dynegy agrees with Secretary Perry's assessment. As described in more detail above, if the markets cannot be preserved, the sizable benefits that have been achieved via organized markets will be wiped out and grid reliability will be at risk. The harm of these state policy interventions to wholesale market participants is immediate and irreparable; with otherwise competitive and economic resources being replaced by less economic subsidized resources. As continued state support for certain resources or resource types distorts the wholesale markets, non-subsidized market participants like Dynegy will have to make substantial changes to strategy, and reduce or suspend planned investments, capital improvements, and hiring. Many competitive assets are now at great risk for retirement. The adverse impacts of these state actions will be felt beyond the borders of the state enacting the subsidy because of the interstate nature of these wholesale markets.

6. In light of current and future state actions, what role should the RTO/ISO play in ensuring resource adequacy? Specifically, do you see a diminished role for the RTO/ISO? Under what conditions should a state intervene in a resource's entry and exit decision and at what point could any such intervention affect the RTO's/ISO's role in ensuring resource adequacy?

With the proliferation of state subsidies that are negatively impacting the competitive markets and unsubsidized market participants, the role of FERC and the RTO/ISOs has become more critical than ever. States should not directly intervene in a resource's entry or exit decision in a competitive construct. If they do, they must bear the full cost of that intervention and the markets must be insulated from the impacts. In competitive markets, the RTO/ISO is responsible for ensuring resource adequacy. The artificial retention of uneconomic units and the resulting distortion of market prices directly impacts resource adequacy. FERC must protect price formation so that the RTO/ISOs can continue to ensure resource adequacy.

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[6] Secretary of Energy Rick Perry's Memorandum to Chief of Staff, Study Examining Electricity Markets and Reliability, April 14, 2017, available at: https://s3.amazonaws.com/dive_static/paychek/energy_memo.pdf.