

Last year, the GOP majority on FERC decided that state clean energy policies were distorting energy markets in the country's largest grid region. Because they provided incentives for power producers, FERC ruled, those policies should be considered subsidies. It directed grid operators to introduce new policies to counter those subsidies and halt the dreadful onslaught of cleaner energy. FERC's remedy will cost consumers in that part of the country billions of dollars, in the names of perfecting market competition.

The issue involves the capacity market — which, despite the name, is not a market where buyers actually end up owning anything. Instead, it's a regulatory contrivance for ensuring that enough new generation is built. Essentially, the market generator figures out how much power will be required in the future. Power producers then offer commitments to produce the required amount of electricity. The producers who offer to do so most cheaply win, and utilities are then charged a share of the total amount based on their projected future needs. The utilities don't end up with the enforceable right to purchase power at any particular price from any particular producer, which is why it's not a real market. Anyway, FERC's theory is that subsidies allow some energy sources to give artificially low bids, depressing the market price.

One problem with FERC's approach is that it's extremely hard to define when a regulatory measure should be considered a subsidy. Within the domain of conventional ratemaking by state utility commissions, there are often disputes about whether measures such as accelerated depreciation or compensation for stranded assets are valid cost-adjustments or subsidies. If FERC continues forward with the logic of its approach, it will find itself micromanaging state utility regulation. But the flaws in FERC's approach run deeper.

FERC seems to have lost track of a basic principle of energy law, laid down by the Supreme Court in a case called *Hope Natural Gas*. That principle says that the test for prices in energy markets isn't based on theoretical nicety but on pragmatism: whether the industry will get sufficient income to meet consumer needs and raise investment funds for the future. Based on that pragmatic test, there's no problem. The area in question has more generating capacity than it needs. Under FERC's new rule, consumers will get cheap power from renewables, but will then be forced in the capacity market to compensate other producers for commitments to produce power that isn't actually needed.

It's enlightening to compare capacity markets to another form of regulatory market, cap-and-trade systems. Consider a cap-and-trade scheme where the regulator sets a cap for carbon emissions and then auctions off permits for emissions up to the cap. You can see the similarity to capacity markets: in both cases, regulators decide how much of something they want — total carbon emissions in one case, power capacity in the other. They then use an

auction to get what they want in a cost-efficient way.

To pursue the analogy further, consider the effect of a subsidy in a cap-and-trade system. For instance, suppose that a state has a carbon trading system and that a city decides to subsidize a nearby wind project, which will replace some fossil fuel generation. By reducing the fossil fuel generation, the city's subsidy helps the state achieve its emissions cap, at a lower cost to consumers elsewhere in the state where fewer cuts will be needed. It's true that the city has interfered with the pristine competitive workings of the state's carbon market. But it's very hard to imagine that the state would complain at getting some voluntary help from the city in achieving the state's target.

The same project is supplying new generation capacity, helping FERC meet its goal of ensuring that power needs are met without unnecessary cost to consumers. Yet FERC is appalled that the city has reduced costs to consumers. It's requiring the grid operator to ignore the amount of capacity that's actually available from this source, so the capacity market will now be designed to serve imaginary power needs. And the cost of filling that imaginary need will inevitably be passed along to consumers — a cost that is [estimated](#) in the billions of dollars.

If that makes sense to you, consider putting in your application for the remaining vacancies on FERC. Your ability to get outside the rationality box is just what the Trump Administration is looking for.