

Technical Conference Comments of Seth Kaplan*

It is far too easy when dealing with the sophisticated subject matter at issue in this docket to immediately descend into details, fascinating legal doctrines, and complex sets of interacting factors and facts. It is useful to zoom back out to first and basic principles and that is what I will try to do here, along with responding to the questions in the Technical Conference Notice.

The first place to start is with a recognition that this entire enterprise is an exercise in cooperative federalism. It is essential to be aware of both the boundaries between state and federal jurisdiction and the respective powers of those coordinated sovereigns. The need for comity between the States and the Federal entities is essential. The “Federal entities”, largely FERC and the Public Utilities (in particular the ISOs/RTOs) exercising delegated Federal authority, must voluntarily craft rules, markets and patterns of behavior that foster cooperation as much as possible and the States must participate in that effort and coordinate their own efforts. In electricity regulation and market operations, as in environmental regulation and protection and public safety, the public is best served when the State and Federal parties see each other as partners, not threats, and try to the maximum extent possible to help the other advance their goals and practices.

This is not just a principle needed to smooth human interactions – it is essential if everyone involved is going to do their job. The States have critical responsibility for environmental protection, consumer protection and retail electricity regulation. These are immutable duties under the “police power” that is preserved in our constitutional system by the Tenth Amendment, and in the case of retail electricity policy and regulation, by the Federal Power Act. The States would be asleep at a critical switch if they failed to interact with the federal electricity regulatory system while discharging these duties – tailoring state regulation to the reality established by the federal system where possible and helping to shape the exercise of federal authority where possible.

Shifting to the Federal side of the ledger, those exercising federal authority (FERC and the ratemaking utilities, including the ISOs/RTOs) are directed by the Federal Power Act to put in place “just and reasonable” rates. A rate that is formulated in a manner that is willfully ignorant of state resource selection and environmental policy is virtually certain to be unjust and unreasonable. The animating principle behind the rulemaking that brought us Order 1000 was this notion that “failing to plan is planning to fail” and is very applicable here.

This point was driven home quite firmly in the recent D.C. Circuit decision ([Emera Maine v. FERC](#)) which once again identified “state public policy requirements” as a legitimate driver of current and future cost which the RTO/ISO or other wholesale tariff-maker must and should take into account.

Willful blindness to these visible drivers of technology and resource change is imprudent and a sure path to unjust and unreasonable rates.

Meeting state policy priorities in a cost effective manner, avoiding this pitfall, will require use of all tools. This will mean not just reforming markets; it also means ensuring new projects are able to interconnect to the wholesale electric system in a speedy and economical manner and that transmission planning and cost allocation systems facilitate appropriate projects and improvements. Building cost-effective transmission infrastructure, with broad cost-allocation among all beneficiaries, will allow clean power to flow and let states meet their policy goals through market-based mechanisms at the lowest cost.

* Senior Manager for Regional Government Affairs, EDP Renewables and Board Chair, RENEW Northeast – speaking for myself, not my company or for any other RENEW member.

1. What objectives or policy priorities, if any, are states considering implementing in the coming years?

The climate and environmental objectives and policies that are driving the exercise by the States of their power and responsibility for resource selection is clearly the biggest issue at stake here. A number of States have chosen, quite rationally given the evidence and analysis of science, to address the fundamental and existential threat of global warming. As part of that effort they have adopted policies and programs that apply the resource selection power of the State to the effort to build a new fleet of non-emitting electricity resources.

As the Supreme Court made clear in Hughes v. Talen, efforts by States to foster the production of new generation, especially clean generation, is a legitimate exercise. That undertaking by a State is fully consistent with the Federal statutory and constitutional system under which we all must operate.

Considering the scientific evidence that has animated state, regional, federal and international efforts in this area (See e.g., Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act, 74 Fed. Reg. 66496 (Dec. 15, 2009) and supporting record) it is very predictable that States would address this most fundamental of threats – and do so by regulating emissions from electricity generation, a major source of Greenhouse Gas emissions over which the States exercise considerable authority.

2. In a multi-state RTO/ISO, if one state’s policy priorities come into conflict with another state’s policy priorities to what extent should, and/or can, the wholesale markets resolve or mitigate that conflict?

Addressing this issue requires careful analysis of whether state policy priorities are actually in conflict with the design of federally regulated wholesale markets. If one state is seeking a particular commodity (for example, long term commitments to provide electricity from renewable zero-emissions sources) and utilizes a market mechanism (like an auction or an open and competitive procurement process) it is possible that doing so could have an incidental effect on the customers in another state – but that incidental effect should not be mischaracterized as a conflict.

It is nearly inevitable, and quite common, for the policies and actions of one state to have an incidental effect on the residents of other states. For example, one state might make strong efforts to foster energy efficiency, reducing electrical demand in that state and having an effect on regional electricity prices. Conversely, a state might undertake a legitimate industrial policy that sparks the building of facilities that consume significant amounts of power, spurring an increase in demand and again creating an inevitable effect on electricity markets and prices which would change the actual bills of customers in other states. The test must truly be if the state is pursuing a legitimate goal (like environmental protection) through a legitimate method and if the effect on the residents of another state are simply incidental.

Wholesale markets can provide a useful barometer for quantifying or liquidating the changes that state policy may help inspire. For example, the encouragement of renewable generation may have an impact on clearing prices for all consumers in a region, although the net impact on individual locales may vary. As the Supreme Court made clear in Hughes it is perfectly legitimate for States to take steps that further an appropriate state interest that incidentally affects prices.

3. What specific features of the existing market design, if any, would you seek to modify to meet your state and region's policy goals?

Existing wholesale markets are almost all based on locational marginal prices, or LMP. LMP makes an assumption that there is substantial operating costs that can be reflected in an offer price and that those prices and infra-marginal revenues will be enough to support generation. That has already shown weakness by the need in several markets for capacity prices, which are paid on a need calculated by the ISO/RTO. As new resources – with very low operating costs such as wind and solar – become more prevalent, that system, even with the productive changes initiated by MISO, becomes more difficult to sustain. The market design – in its totality including substantial market mitigation rules – cannot support the needed generation, either renewable or otherwise. We may be moving to a new world where the LMP can no longer be the cornerstone of our markets, not because of some harmful state action, but simply because of the increasing diversity of the generation fleet and the shift to lower operating cost resources. The shift to differentiated markets that reward different characteristics like peaking capability or stable pricing due to a zero-fuel cost is emerging already. For example the reward-for-peaking capability, which would benefit some natural gas-fired resources or the emerging energy storage resource, can be seen as already emerging in constructs like the performance bonuses and penalties being layered on to capacity markets.

4. In light of current and future state actions to secure specific resources outside of the centralized energy and capacity markets (out-of-market actions), what role do you see the RTO/ISO having in managing the procurement of capacity for resource adequacy in the long-term?

As discussed above, the capacity markets are being pulled in multiple directions. The performance incentives and penalties combined with the single clearing price and capacity price lock-in design do their job of incentivizing construction of low capital cost, high capacity resources – like Combined Cycle natural gas-fired power plants.

However, these revised capacity markets are not designed to reward other resources that are marching forward due to technological changes and environmental imperatives (e.g. wind and solar). As many States have argued in a number of proceedings and contexts this can lead to customers paying twice – first for the resources coming on-line due to state programs and again for the capacity that is in part needed because the RTO/ISO capacity markets and need determinations are not appropriately recognizing the capacity value of those resources.

But it is very possible to reconcile RTO/ISO mechanisms for both capacity procurement and transmission planning with state clean energy policies. For example, New England discussions on transmission development to serve new land-based and offshore wind resources have been taking place within state RFPs, pursuant to state clean energy policies, not under the ISO administered Tariff. This is simply untenable: NESCOE study indicates that if New England does not build new transmission to allow new on-shore wind resources to move power to population centers, both new and existing on-shore wind resources will operate less often and earn less revenue in the energy market in 2025 and 2030.

Under an approach RENEW has proposed, the ISO, the EDCs and states would work cooperatively to manage resource procurements in a manner that is consistent with legitimate State policy objectives.

The ISO will study the Network Upgrades that would be needed to enable proposed renewable generation that is sitting in its queue to connect to ISO's grid. The EDCs and state regulators will have the discretion (e.g., if there were to be a simultaneous competitive clean energy RFP) to consider competitive solutions to satisfy the need for Network Upgrades. The EDCs in consultation with their state regulators would have the option to agree to bear the cost and to specify the cost allocation in the name of public policy, to meet RPS and other needs. The project-specific cost allocation methodology identified by the opting-in EDCs will be filed for FERC approval by the applicable participating transmission owners as a participant funded project, in accordance with the Transmission Operating Agreement or, where appropriate, by an Elective Transmission Upgrade project sponsor.

5. To the extent state policy priorities are effectuated outside of the centralized energy and capacity markets, what long-term impacts, if any, might such actions have on the ability of these markets to provide signals for efficient entry and exit and ensure resource adequacy?

The centralized markets are important at this point in establishing prices for energy. However, the non-organized areas also produce energy values, such as in the Northwest. Perhaps the future is a world where the contracted for prices for energy supply – either with states, private entities or the ISO/RTO become the standard for value in the market. The energy and capacity markets may become the residual market – providing a highly valuable price indicator but not clearing large amounts of energy. Or, perhaps there are different prices that should be fed into the market mechanisms beyond short-run marginal costs that will allow the centralized markets to clear greater amounts of energy but actually reflect a long-term marginal cost.

It is also important that the external costs that drive state policies eventually be reflected in the dispatch algorithm. If the states in a region are all willing to pay much more for carbon-free energy, then perhaps that value – now in their contracts – can and should be reflected in the market price.

Suffice it to say that major changes will be needed in the LMP/capacity markets to reflect the new certainties – almost certainly in more differentiated market segments as discussed above.

6. Is there a way to achieve state or regional policy objectives with the centralized energy and capacity markets through potentially new or different market mechanisms? If so, what would be the elements of a policy solution to accommodate the objectives of your state or region while preserving the competitiveness and efficiency of wholesale markets?

Integrating State procurements, and similar mechanisms, with RTO/ISO administered markets will require that those markets reflect the costs of the attributes that are being sought by the states including reflecting longer-run marginal costs in the markets, or at least review the market mitigation rules to reflect the changes now occurring. Increasing the tenor of procurements will help in this respect - for example, as discussed above, the three year period of the ISO-NE capacity market simply can't support a resource like wind or solar that has higher capital and lower operating costs.

In an attempt to go beyond this incremental approach RENEW, in the NEPOOL IMAPP initiative, has proposed a Forward Clean Energy Market ("FCEM") that will allow market based procurement of new non-emitting MWhs of energy and environmental attributes to meet state policies. It also proposed a mechanism to monetize the contribution from existing non-emitting resources to meeting state

environmental policies and insure that these resources remain in the market. This kind of approach was clearly identified as appropriate and lawful by the D.C. Circuit in the Emera decision which clearly contemplates state policies and decisions as a legitimate driver of cost and the planning and market design decisions that flow from recognition of those facts-on-the-ground.

Realistically, the forward market design approach faces several challenges. It requires cooperation between FERC (and utilities, including RTO/ISOs, exercising FERC-delegated authority) and the states. As was the case with the transmission planning decisions at issue in Emera v. FERC, states are unlikely to give FERC (or an entity exercising FERC delegated authority) even a small degree of authority over the design of any new program. States want to retain full control over the timing of procurements, type of technology procured, and location deployed.

It is not clear that sharp delineation between Federal and State roles in the transmission process enumerated in Emera applies in the generation compensation context. It seems possible that FERC could approve a tariff that seeks to implement state policies – however, given the reality of an (understandable) desire by the States to maintain control over the implementation of their own policies this seems like a very unlikely scenario to play out.

Given this reality what can FERC, and the entities it regulates, do to accommodate these state policies and meet their many other obligations (including resource adequacy and reliability)?

In addition to the market design changes described at length above the major action that is needed is effective and aggressive action to streamline and accelerate project interconnection and build the transmission that facilitates state policy implementation.

The Emera decision reaffirms once again that FERC and the entities it regulates have the ability (and I would argue obligation) to recognize state policies, like Renewable Portfolio Standards and procurements, as cost drivers that must be recognized in the transmission planning and cost-allocation process.

This is the critical shift in thinking that is at the core of maintaining the federalist balance: RTO/ISOs and other regulated utilities that propose FERC regulated rates need to see state policies as external drivers that must be accommodated.

This mindset needs to apply equally to both market design and transmission planning and cost allocation. If a state sponsored program is depending upon zero-emissions resources that include geographically distant generation then it is appropriate for the federally regulated transmission planner to move forward transmission, both through planning that recognizes these state policies and broad cost allocation to appropriately spread the cost among all beneficiaries, to facilitate cost-effective attainment of state goals.