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State Electric Generator Subsidies Challenge FERC Markets

By **Richard Drom** (April 24, 2018, 2:11 PM EDT)

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The boundary under the Federal Power Act between actions that are the exclusive jurisdiction of the Federal Energy Regulatory Commission and those actions that remain subject to states' jurisdiction will likely again be tested in the coming months. The triggers for such analysis are an increasing number of state actions to encourage the operation of uneconomic coal and nuclear energy electricity generation facilities.

FERC's authority to effectively operate competitive wholesale markets will again be challenged by these out-of-market state actions. The jurisdictional tension regarding actions that states can take has been brewing for years.

The U.S. Supreme Court issued a landmark decision in 2016 regarding the ability of a state to provide economic subsidies to gas-fired electricity generation facilities (if the capacity from the facilities cleared in the FERC-approved capacity auction) to reduce Maryland's electricity prices. In Hughes v. Talen Energy Marketing, the court held, in part, that Maryland's subsidy program for gas generators was preempted because it disregarded the interstate wholesale rate that FERC requires. The court, however, emphasized the limited nature of its decision:

> We therefore need not and do not address the permissibility of various other measures States might employ to encourage development of new or clean generation, including tax incentives, land grants, direct subsidies, construction of state-owned generation facilities or reregulation of the energy sector. Nothing in this opinion should be read to foreclose Maryland and other States from encouraging production of new or clean generation through measures 'untethered to a generator's wholesale market participation.'"[1]

Since then, other states (e.g., New York and Illinois) have implemented programs to subsidize nuclear powered generation facilities. Some have argued that such subsidies impermissibly interfere with FERC's regulation of wholesale energy markets under the FPA. These state subsidy programs are currently being reviewed by federal appellate courts, which ultimately may lead to a clarifying Supreme Court decision.

Regional transmission organizations such as ISO-New England and PJM Interconnection LLC have proactively attempted to amend their FERC tariffs to protect their energy and capacity markets from such out-of-market activities. For example, ISO-NE filed a two-part capacity resource market proposal, or CASPR, in April of 2017.

CASPR was designed prevent resources that were subsidized by tax credits or mandates from artificially depressing prices in ISO-NE's capacity market.[2] Two of FERC's commissioners agreed with the CASPR tariff proposals and held that CASPR will allow ISO-NE to continue to provide resource adequacy at just and reasonable rates.

They also concluded that FERC would use its so-called minimum offer price rule, or MOPR, as a "standard solution" to address the impacts of state policies on the wholesale capacity markets. Commissioner Cheryl LaFleur concurred in part with the decision. Commissioner Robert Powelson dissented regarding approval of the CASPR procedures.

LaFleur and commissioner Richard Glick questioned whether MOPR provisions would be a "standard solution" to protect competitive wholesale markets. In a partial dissenting opinion, Glick argued that reliance on MOPRs or similar policy options will "come to rank as a historically serious misstep." Glick concluded that MOPR should only be used "for which it was originally intended: to prevent the exercise of buyer-side market power."

FERC will soon have another opportunity to examine the interface of MOPR, state subsidies and competitive wholesale energy markets. On April 9, 2018, PJM filed two proposals to address state subsidies in PJM's markets. PJM proposed two alternate approaches to subsidies in Docket No. ER18-1314: (1) a two-stage capacity repricing proposal (that has similarities to CASPR); or (2) a "MOPR-Ex" proposal that had been developed by the PJM Independent Market Monitor and by many PJM stakeholders.

PJM filed these unusual "dueling proposals" at the request of the PJM board of managers based, in part, upon the almost two-thirds support of the PJM members for the MOPR-Ex approach. Both proposals are very complex (the full PJM filing is 630 pages).

Briefly, under the capacity repricing approach, there would be a two-stage capacity auction. The first stage of the auction would use subsidized prices; it would determine resource commitment. In the second stage, PJM would substitute competitive prices for any subsidized resource prices, and then PJM would determine the clearing price for all resources committed in the first stage. The single clearing price that results from the second stage of the capacity repricing proposal would be paid to all capacity resources and charged to all zonal load.

In contrast, the MOPR-Ex proposal would expand and extend PJM's existing MOPR; the new MOPR-Ex rules would apply to offers from both existing resources and new resources. In the capacity auction, PJM would use the greater of the resource's avoidable cost rate or the resource's specific opportunity cost as the exception to the MOPR floor price measure of a competitive offer.

The MOPR-Ex proposal would "grandfather" existing renewable resources, and also offer defined exclusion for future renewable resources; the MOPR-Ex rules would not apply to demand resources.

According to PJM, the key conceptual difference between its capacity repricing proposal and the MOPR-Ex proposal is that MOPR-Ex resets a subsidized offer to a competitive price level before determining whether the offer clears the auction. In contrast, PJM's proposed capacity repricing proposal resets a subsidized offer to a competitive price level after the offer clears at its subsidized level, as part of an initial commitment phase of the capacity auction.

Interventions and protests in PJM's Docket No. ER18-1314 are due on May 7, 2018.

Today, approximately 70 percent of all of the electricity that is consumed in the U.S. is transmitted pursuant to RTO and independent system operator tariff rules that have been approved by FERC. As a result, the nation has an important interest in protecting the

competitive wholesale energy markets from interference by potential out-of-market subsidies.

On the other hand, states also have a fiduciary obligation to not only provide electricity that is reasonably priced and reliable, but also to provide such energy in an environmentally sensitive manner (e.g., promoting wind, hydroelectric, solar and nuclear power that minimize carbon emissions). The inevitable tension between these potentially irreconcilable goals will need to be resolved by Congress or by the Supreme Court.

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[1] Hughes v. Talen, slip at 15.

[2] See Docket No. ER18-619.

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