

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

)
) Docket No. ER18-1314
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*PJM Interconnection, Revisions to
Address Impacts of State Policies*

Comment of the Harvard Electricity Law Initiative¹

PJM’s proposed tariff revisions would jeopardize the viability of a program of cooperative federalism. The Commission should reject PJM’s efforts to force it to choose between two flawed proposals and decline PJM’s request for authority to select among state generation procurement models.

PJM observes that an “emerging trend in PJM is for owners of [] legacy assets to seek out-of-market support from states to forestall retirement and defeat the design objective of PJM’s market.”² However, rather than targeting this relatively narrow concern, PJM proposes to isolate from the capacity construct resources that sell state-regulated environmental attributes.³ PJM fails to explain why it equates state support for legacy assets with competitive state programs for environmental attributes, even though it concedes that the latter affect wholesale rates “to a lesser degree,”⁴ or why it proposes to pay inflated rates to resources receiving other state subsidies. If the Commission approves one of PJM’s proposals, it should expect a steady stream of §206 complaints about laws and regulations ensnared or uncaptured by PJM’s arbitrary rules. The Commission should decline PJM’s invitation for interminable conflict with state policies.⁵

Commission approval would substantially expand RTO authority in a field of shared authority. “Need for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States.”⁶ State restructuring and Commission efforts to foster competitive wholesale markets changed how states

¹ The Harvard Electricity Law Initiative is an independent policy organization based at Harvard Law School’s Environmental & Energy Law Program. We produce legal analysis to inform public debate and promote practical approaches to solving the electricity sector’s legal challenges.

² PJM Transmittal Letter at 14.

³ PJM’s MOPR-Ex proposal includes an option for an exemption for state renewable portfolio standards (RPS). However, PJM has indicated that it is “willing to accept a MOPR-Ex proposal that does not include an RPS exemption.” *Id.* at 112–114.

⁴ *Id.* at 36.

⁵ See *PJM Interconnection*, 137 FERC ¶ 61,145 at P 91 (2011) (“States can file under section 206, or participate in filings by generators, if they believe that the MOPR interferes with a legitimate state objective.”)

⁶ *Pac. Gas & Electric v. State Energy Comm’n.*, 461 U.S. 190, 205 (1983).

exercise authority over generation procurement, but states did not cede authority to the Commission and Congress did not materially alter the Commission's authority under the Federal Power Act. States "may regulate within the domain Congress assigned to them,"⁷ such as by mandating that utilities purchase particular types of generation or environmental attributes,⁸ "even when their laws incidentally affect areas within FERC's domain."⁹ The Commission has understood its role as "balanc[ing] [its] responsibility to promote economically-efficient prices, while accommodating states' ability to pursue legitimate policy objectives."¹⁰

PJM proposes to divorce capacity rates from resource adequacy¹¹ with the goal of bringing "billions of dollars of private equity earmarked for investment in the sector" into the market.¹² Consumers will pay more, and investment motivated by PJM's higher rates could effectively crowd out the resources favored by state policies. Ultimately, the resource mix might evolve to meet PJM's rules rather than state policies. In the meantime, PJM would have authority to pick and choose among state generation procurements, dramatically expanding the narrow authority it now has under the Minimum Offer Price Rule (MOPR).

PJM claims that immediate action is necessary because states are renegeing on their commitments to competitive wholesale markets.¹³ But state generation procurement policies have long co-existed with restructuring and pre-date PJM's capacity construct by nearly a decade.¹⁴ The Commission's 1999 RTO guidelines did not suggest that RTOs would play any role in capacity procurement.¹⁵ When discussions about expanding RTOs' roles were in process at the Commission, states raised numerous objections to capacity constructs, including that they would interfere with state generation preferences and would not reflect state environmental policies.¹⁶ States did not sign up to have a regional system operator pick and choose among their generation procurement programs, and any assertion to the contrary is unsupportable.

⁷ *Hughes v. Talen*, 136 S.Ct. 1288, 1298 (2016).

⁸ See *infra* notes 23–28 and associated text.

⁹ *Hughes*, 136 S.Ct. at 1298.

¹⁰ *ISO New England*, 158 FERC ¶ 61,138 at P 68 (2017); see also *New York Indep. Sys. Operator*, 122 FERC ¶ 61,211 at P 112 (2008); *New York Pub. Serv. Comm'n. v. New York Indep. Sys. Operator*, 153 FERC ¶ 61,022 at P 51 (2015).

¹¹ *Id.* at 11 (claiming that this investment is not "needed" to maintain resource adequacy).

¹² PJM Transmittal Letter at 13.

¹³ PJM Transmittal Letter at 21–24.

¹⁴ See, e.g., New Jersey SB7 (1999) (Electric Discount and Energy Competition Act that included a renewable portfolio standard); Illinois PA 90-561 (1997) (Renewable Energy, Energy Efficiency, and Coal Resources Development Law of 1997 that was passed with the state's restructuring law); Galen Barbose, Lawrence Berkeley National Lab, "U.S. Renewables Portfolio Standards: 2017 Annual Status Report," Jul. 2017, at p. 8, <https://perma.cc/VXK6-RGTQ> (showing that 22 states enacted RPSs prior to 2007, including four PJM states and D.C.; Illinois (2007), North Carolina (2007), Ohio (2008), and West Virginia (2009) passed RPS laws shortly thereafter).

¹⁵ See Order No. 2000, 89 F.E.R.C. ¶ 61,285 (1999).

¹⁶ See *infra* at 5–7.

PJM’s proposals would erect new barriers to market entry for some state programs and would represent a major step backwards for the Commission’s long-standing efforts to foster competition. Notably, PJM’s proposals explicitly favor monopolists over non-utility producers. PJM would pay different rates to a facility owned by a vertically integrated utility and an otherwise identical facility owned by an independent power producer, even if both facilities sell environmental attributes.¹⁷ Just and reasonable rates “enhance[e] competition . . . [by] break[ing] down regulatory and economic barriers that hinder a free market in electricity.”¹⁸ PJM would instead provide monopolists with a competitive advantage and disincentivize states with vertically integrated utilities from adopting competitive procurements. This result would be a surprising turn for the Commission’s market-based rate regulation.

The Commission should deny PJM’s second request in four years to raise capacity rates.¹⁹ PJM recently “state[d] without reservation [that] there is no immediate threat to system reliability.”²⁰ Just two years ago, PJM’s detailed analysis revealed that “[t]he abundance of merchant projects coming online in PJM indicates that the market is providing adequate returns to attract capital.”²¹ While the Commission may approve a tariff filing under §205 without concluding that the resulting tariff is “precisely right,”²² the Commission is not compelled to accept either PJM proposal as just and reasonable.

Capacity Procurement Is a Program of Cooperative Federalism

States have always enjoyed authority over utility portfolios,²³ including ordering a utility to “purchase power from . . . a particular type of resource.”²⁴ It is “settled law” that states may specify generation technologies eligible to participate in a utility procurement.²⁵ States may

¹⁷ PJM Transmittal Letter at 80 (showing decision tree).

¹⁸ *FERC v Electric Power Supply Association (EPSA)*, 136 S.Ct. 760, 768 (quoting *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1 of Snohomish Cty.*, 554 U.S. 527, 536 (2008)).

¹⁹ *See PJM Interconnection*, 151 FERC ¶ 61,208 (2015) (approving PJM’s 2014 capacity performance rules); *Advanced Energy Management Alliance v. FERC*, 860 F.3d 656 (D.C. Cir. 2017) (upholding the Commission’s orders).

²⁰ PJM Letter to Secretary Rick Perry (Mar. 30, 2018), <http://www.pjm.com/-/media/documents/other-fed-state/20180330-response-to-fe-solutions-request-for-emergency-relief.ashx>.

²¹ *Resource Investment in Competitive Markets, PJM Interconnection*, 29 (May 5, 2016), <http://www.pjm.com/~media/library/reports-notice/special-reports/20160505-resource-investment-in-competitive-markets-paper.ashx> (“Resource Investment Whitepaper”); *id.* at 24 (“Given the level of capital being attracted to PJM, it seems highly implausible to claim the market is not compensating merchant investors enough for risks they assume.”).

²² *Wisconsin Pub. Power v. FERC*, 493 F.3d 239, 260 (D.C. Cir. 2007) (quoting *ExxonMobil Gas Mktg. Co v. FERC*, 297 F.3d 1071, 1084 (D.C. Cir. 2002)).

²³ *Energy Policy Act of 1992*, 106 Stat. 2776, 2796 (codified at 16 USC §§ 2602) (defining integrated resource planning and encouraging states to adopt the practice); Order No. 888, 61 Fed. Reg. 21540, 21625 n. 544 (1996).

²⁴ *S. California Edison*, 70 FERC ¶ 61,215 (1995); *see also Midwest Power Systems, Inc.*, 78 FERC ¶ 61,067 (1995) (a state can order a utility to “purchase power from . . . a particular type of resource”).

²⁵ *Allco*, 861 F.3d at 101; *Solomon*, 766 F.3d at 255 (“The states may select the type of generation to be built—wind or solar, gas or coal—and where to build the facility.”).

also “incentivize the construction of new generation facilities [and] limit new construction to certain types of generation resources.”²⁶ Renewable energy credits (RECs) and other environmental attributes are “inventions of state property law,”²⁷ and the Commission has repeatedly disclaimed jurisdiction over their sale.²⁸

The Commission has authority over wholesale capacity rates because they directly affect wholesale energy rates.²⁹ In upholding Commission regulation of an RTO capacity construct, the D.C. Circuit drew a distinction between “direct regulation of generation facilities” — which is beyond the Commission’s reach — and determination of the installed capacity requirement, which directly “affects rates within the Commission’s jurisdiction.”³⁰ According to the panel, “[t]hat reasonable concerns about system adequacy might factor into the fairness of those charges is precisely what brings them within the heartland of the Commission’s [] jurisdiction.”³¹

Acceptance of a PJM proposal would accelerate the steady expansion of RTO authority over capacity procurement. Initially, Commission-jurisdictional markets did not have a centralized capacity construct. Load serving entities (LSE) in PJM inherited a bilateral capacity trading mechanism that was designed to allocate generation responsibility among vertically integrated utilities.³² In 2003, the Commission saw little need for anything more, stating that its “role with regard to resource adequacy is a supporting one and that state and local governments must take the lead.”³³

Just one year later, the Commission hypothesized that “locational requirements for installed capacity may prove an effective approach to create stable revenue streams,” although it idealized that energy markets “should encourage LSEs to engage in long-term bilateral contracting to support needed investment.”³⁴ In 2006, the Commission concluded

²⁶ Brief for the United States as Amicus Curiae, Supreme Court Docket Nos. 14-614 and 14-623 (Jan. 2016).

²⁷ *Wheelabrator Lisbon, Inc. v. Conn. Dep’t of Pub. Util. Control*, 531 F.3d 183, 186 (2d Cir. 2008)

²⁸ *American Ref-Fuel Company*, 105 ¶ FERC 61,004 at P 3 (2003); *Aircraft Services Corp.*, 122 FERC ¶ 62,118 (2008); *Smoky Hills Wind Project II*, 125 FERC ¶ 62,286 (2008); *Morgantown Energy*, 139 FERC ¶ 61,066 (2012); *WSPP*, 139 FERC ¶ 61,061 (2012); *Windham Solar*, 156 FERC ¶ 61,042 at P 4 (2016); Brief for the United States as Amicus Curiae, Supreme Court Docket Nos. 14-614 and 14-623 (Jan. 2016) (“Permissible state programs may include a requirement that local utilities purchase a percentage of electricity from a particular generator or from renewable resources, or the creation of renewable energy certificates to be independently used by utilities in compliance with state requirements.”).

²⁹ *New Jersey Bd. of Pub. Utils.*, 744 F.3d 74, 95 (the Commission “argues that courts have consistently upheld its jurisdiction over its ‘regulation of capacity markets, including charges, requirements, and market rules, as practices affecting rates. . . .’” (quoting FERC’s brief)).

³⁰ *Conn. Dept. of Pub. Util. Control v. FERC*, 569 F.3d 477, 485 (D.C. Cir. 2009).

³¹ *Id.* at 483.

³² Prepared Statement of Andrew Tubbs on behalf of the Pennsylvania Public Utilities Commission, Docket No. ER05-1410-000 (Feb. 3, 2006).

³³ *MISO*, 103 FERC ¶ 61,210 at P 19–20 (2003).

³⁴ *PJM Interconnection*, 107 FERC ¶ 61,112 at P 20 (2004).

that PJM’s bilateral capacity construct will “fail to achieve the intended goal of ensuring reliable service,”³⁵ in part because the construct did not send locational price signals.³⁶

In approving a settlement that created the Reliability Pricing Model (RPM), the Commission explained that the “new market . . . will enable PJM to obtain sufficient energy to reliably meet the needs of consumers.”³⁷ The Commission’s order repeatedly ties the new capacity construct to PJM’s responsibility “for ensuring that its system has sufficient generating capacity to meet its reliability obligations.”³⁸ Yet the Commission also saw a continued role for states, rejecting arguments that offers from state-sponsored resources should be subject to the MOPR. The Commission reasoned that an exemption for state resources “enables states to meet their responsibilities to ensure local reliability.”³⁹

Five years later, PJM eliminated that exemption, subjecting state-sponsored resources to rules designed to prevent the exercise of buyer-side market power.⁴⁰ Those state policies “operate[d] within the auction”⁴¹ and benefitted precisely the type of capacity that the Commission had determined could be used to suppress capacity rates.⁴² While the Third Circuit upheld the Commission’s decision to approve PJM’s tariff revisions, it also admonished the Commission for its “more than mildly disturbing” reversal premised on “foreseeable outcomes [that] approached fruition.”⁴³

PJM wrongly suggests that states embraced RPM’s creation and evolution and are now being hypocritical for supporting various resources with environmental attributes.⁴⁴ While states were eager to reap the efficiency gains of competitive electricity markets, they maintained control over utility portfolios and enacted generation procurement policies to drive the regional resource mix. New Jersey enacted an RPS law in 1999, and Maryland, Delaware, and Pennsylvania also enacted RPS laws prior to the Commission’s approval of a capacity construct.⁴⁵ Illinois, Ohio, North Carolina, and West Virginia followed shortly thereafter.⁴⁶ In 2005 and 2006, as discussions at the Commission about a capacity construct were progressing, PJM states raised numerous objections, including:

- The Maryland PSC urged the Commission to explore bilateral alternatives to the RPM. It hoped that a capacity construct would merely be “a bridge to accommodate an orderly maturation of wholesale electric markets . . . without the embedded

³⁵ *PJM Interconnection*, 115 FERC ¶ 61,017 at P 29 (2006).

³⁶ *PJM Interconnection*, 117 FERC ¶ 61,331 at PP 44–50 (2006).

³⁷ *Id.* at P 1.

³⁸ *Id.* at P 2; *see also id.* at PP 3, 4, 6, 44, 45, 68, 78, 80, 147.

³⁹ *Id.* at P 104.

⁴⁰ *PJM Interconnection*, 135 FERC ¶ 61,022 at P 139 (2011); *New Jersey Bd. of Pub. Utils.*, 744 F.3d at 96–102.

⁴¹ *Hughes*, 136 S.Ct. at 1299.

⁴² *PJM Interconnection*, 137 FERC ¶ 61,145 at PP 109–112 (2011).

⁴³ *New Jersey Bd. of Pub. Utils.*, 744 F.3d at 102.

⁴⁴ *See* PJM Transmittal Letter at 21–24.

⁴⁵ Barbose, *supra* note 14.

⁴⁶ West Virginia enacted an RPS in 2009 but repealed it in 2015.

inefficiencies associated with a separate capacity market having significant administratively determined components.” It asked the Commission to ensure that the “capacity market does not become an entrenched regulatory regime.”⁴⁷

- The Pennsylvania PUC observed that “elements of RPM require active administrative discretion by PJM . . . [and] therefore, RPM is not a market-based rate, but an administratively determined rate” that is contrary to Commission and Congressional policy. The Pennsylvania PUC also questioned whether the RPM could “achieve [fuel diversity] or whether it works against such diversity.”⁴⁸ Like the Maryland PSC, the Pennsylvania PUC said that RPM “is and must be considered a short-term solution to transitional problems – not the end state of competitive US electricity markets.”⁴⁹ The Pennsylvania PUC sought rehearing of the Commission’s order establishing the settlement proceeding, arguing in part that the proposed RPM was “in conflict with the Federal Power Act’s reservation of State regulatory authority” over resource adequacy.⁵⁰
- At a Commission technical conference, a New Jersey BPU commissioner expressed concern that locational prices would fail to capture effects of state environmental laws. He asserted that generation development “costs are significantly greater in states that have adopted . . . strong environmental protections.” While these laws “benefit a wide area, the additional costs related to such protection are unfairly shouldered by the energy consumers located in those states that have adopted more stringent standards.” Therefore, because “RPM [] focuses on a single market factor, [] location, [and] does not address the underlying reasons for the disparity [in costs], [it] cannot adequately address these inequities, solve the uneven distribution of capacity, or ensure greater grid reliability.”⁵¹ Ultimately, the New Jersey attorney general filed a request for rehearing of the Commission’s order approving the RPM settlement, asserting that the centralized construct “will raise prices with only speculative benefits.”⁵²
- The Public Service Commission of West Virginia argued that the RPM proposal “improperly intrudes into West Virginia’s jurisdiction over generation units” and cautioned the Commission not to “intrud[e] into [] generation.”⁵³

⁴⁷ Comment of the Maryland Public Service Commission, Docket No. ER05-1410-000 (Oct. 19, 2005).

⁴⁸ Comment and Protest of the Pennsylvania Public Utility Commission, Docket No. ER05-1410-000 (Oct. 19, 2005).

⁴⁹ Post-Technical Conference Comments of the Pennsylvania Public Utility Commission, Docket No. ER05-1410-000 (Mar. 2, 2006).

⁵⁰ Pennsylvania Public Utility Commission Request for Rehearing, Docket No. ER05-1410 (May 22, 2006).

⁵¹ Statement of Commissioner Frederick Butler of the New Jersey Board of Public Utilities, Docket No. ER05-1410-000 (Feb. 3, 2006).

⁵² New Jersey Attorney General Request for Rehearing, Docket No. ER05-1410-001 (Jan. 22, 2007)

⁵³ Comment of the West Virginia Public Service Commission, Docket No. ER05-1410-000 (Oct. 19, 2005).

- When the Commission’s authority over a centralized capacity construct reached the D.C. Circuit, the Ohio Attorney General filed her own brief arguing that the RPM would interfere with state generation procurement and demand-side policies.⁵⁴
- Kentucky, New Jersey, North Carolina, and Pennsylvania regulators joined attorneys general or regulators from six other states on an amicus brief in that case opposing the centralized capacity construct. They argued that the Commission was “seek[ing] to expand its jurisdiction and displace the States’ traditional regulation — to address what it perceives as a shortcoming in the markets FERC created.”⁵⁵
- The Organization of PJM States (OPSI) filed a comment in the RPM settlement docket “ask[ing] as a policy matter whether PJM should be the central generation procurement and reliability authority in the region.” While it recognized that “for the immediate future, there needs to be some form of a capacity construct,” OPSI urged the Commission to ensure that any changes “be short-term.”⁵⁶
- The National Association of Regulatory Commissioners (NARUC) passed a resolution urging the Commission not to exercise its authority over wholesale rates “in such a manner as to undermine State jurisdiction over generation resource adequacy issues” and appealing to FERC and state commissions to “work together in a cooperative manner to assure that each agency exercises its jurisdiction in an appropriate manner.”⁵⁷

It is worth repeating that states hoped that the RPM would be *temporary*; a perhaps necessary concession during a transitional period. Yet, the Pennsylvania PUC offered this prescient observation in 2006:

The RPM proposal places the Regional Transmission Operator in the role of a market participant, market administrator, market monitor and a rate maker charged with administering the RPM revenue offset for each generator. Experience teaches that organizations have a strong bias towards increasing their own scope and importance and an aversion to changes that reduce their role. RPM is an RTO-centric approach to a problem that leads us away from addressing less centralized, more competitive market structures. RTOs are unlikely to favor market design solutions that reduce their role and importance.⁵⁸

⁵⁴ Brief of Amicus Curiae State of Ohio in Support of Petitioner Connecticut Department of Public Utility Control, D.C. Circuit Docket No. 07-1375 (Oct. 15, 2008).

⁵⁵ Brief of Amici Curiae NARUC et al. in Support of Petitioner Connecticut Department of Public Utility Control, D.C. Circuit Docket No. 07-1375 (Oct. 17, 2008).

⁵⁶ Comments of the Organization of PJM States, Docket No. ER05-1410 (Oct. 19, 2005).

⁵⁷ NARUC, Resolution Relating to the Federal / State Jurisdictional Boundaries in Setting Generation Resource Adequacy Standards, Adopted by the NARUC Board of Directors on Jul. 27, 2005, <https://pubs.naruc.org/pub.cfm?id=539FD10C-2354-D714-5144-F7199C39CAFE>.

⁵⁸ Post-Technical Conference Comments of the Pennsylvania Public Utility Commission, Docket No. ER05-1410-000 (Mar. 2, 2006).

PJM's current proposals illustrate this theory in action. PJM seeks for itself the power to choose among state procurement policies and provide lower rates (or no capacity revenue at all) to certain market participants that earn revenue selling environmental attributes. The Commission should decline PJM's request to use the Commission's jurisdiction over practices that directly affect wholesale rates to directly affect the generation resource mix. By elevating the centralized capacity construct above long-standing state generation policies, Commission approval would increase the cost of state policies, favor PJM's preferred resources, and escalate tensions with states. While PJM claims to be acting in defense of the Commission's "first principles" of capacity rate regulation, its proposals have anti-competitive effects and would ultimately benefit a narrow class of investors.

PJM's Arbitrary Rules Are Anti-Competitive and Unrelated to Resource Adequacy

Although it asserts that a "part-subsidized/part competitive market is [] a poor design choice for the critical function of ensuring reliability,"⁵⁹ PJM makes no attempt to contend with the hybrid nature of its market. Its proposals explicitly exclude all generation owned by vertically integrated utilities or public power, roughly 25 percent of the entire market,⁶⁰ and instead target a handful of resources that are compensated for their environmental benefits, which are not recognized by PJM.

In a 2013 article, the PJM Market Monitor wrote that

[v]ertically integrated utilities that receive cost of service rates are effectively receiving an out of market guaranteed long term contract for the sale of capacity. The offers from such utilities into the capacity market have the potential to distort market outcomes and should not be exempted from the MOPR.⁶¹

Nonetheless, PJM cites three reasons for providing vertically integrated utilities with inflated rates: 1) they do not "raise concerns of possibly price suppressive intent;" 2) it "avoids interference with long-standing capacity procurement business models"; and 3) vertically integrated utilities "are unlikely to depend on costly strategies to address the non-self supply portion of their portfolio."⁶² These claims do not withstand scrutiny.

With regard to "price suppressive intent," elsewhere in its proposal PJM claims that a state's motivation for enacting allegedly market-distorting policies is immaterial,⁶³ and recognizes that the Commission has rejected the relevancy of a seller's intent.⁶⁴

⁵⁹ PJM Transmittal Letter at 34.

⁶⁰ *Id.* at 3.

⁶¹ Joseph Bowring, *Capacity Markets in PJM*, ECONOMICS OF ENERGY & ENVIRONMENTAL POLICIES, Vol. 2, No. 2 (2013).

⁶² PJM Transmittal Letter at 73–75.

⁶³ *Id.* at 14 ("... regardless of the state's specific policy motivation . . .").

⁶⁴ *Id.* at 14, n. 37.

Vertical integration is indeed a “long-standing . . . business model,” but PJM fails to explain why it defers to states on that policy choice but not on a state’s decision to support resources for their environmental benefits. PJM does not provide any empirical evidence demonstrating that the policies it targets have greater effects on wholesale rates than the utility business models that it exempts. Its appeal to tradition ignores other long-standing state policies. Renewable Portfolio Standards (RPS) are not as ancient as vertical integration but they do pre-date PJM’s centralized capacity procurement construct.⁶⁵ PJM provides no basis for deferring to some procurement models but not others.

Finally, PJM’s comparison to the Commission’s determination about the MOPR self-supply exemption is unavailing. In the cited May 2013 order,⁶⁶ the Commission determined that a vertically integrated utility would not have an incentive to exercise buyer-side market power. Here, PJM’s proposed utility carve-out has nothing to do with buyer-side market power.⁶⁷ The result of PJM’s proposal is that vertically integrated utilities will have a competitive advantage over non-utility producers. PJM would pay a higher rate for utility-owned capacity than identical capacity owned by a non-utility generator, even if both sell environmental attributes.

This disparate treatment has anti-competitive effects. PJM states allow entities with an RPS obligation to comply with RECs from a facility located anywhere in the PJM region.⁶⁸ PJM’s proposed rules would provide an inflated capacity rate to a facility owned by a vertically integrated utility that uses the renewable energy to serve its own load and sells the RECs to an out-of-state entity with an RPS obligation.⁶⁹ A non-utility plant that sells its energy to PJM or through a long-term contract and RECs to an entity with an RPS obligation would receive a lower capacity payment. In addition, North Carolina recently enacted a renewable energy solicitation program that contemplates competition for new projects between non-utility developers and utilities.⁷⁰ PJM’s proposals would provide Dominion with a competitive advantage over independent developers. For other states in PJM’s footprint with vertically integrated utilities, price inflation would be a disincentive to adopting competitive procurements.

⁶⁵ *Supra* note 45 and associated text.

⁶⁶ *PJM Interconnection*, 143 FERC 61,090 at PP 107–112 (2013).

⁶⁷ PJM may be suggesting that state oversight of vertically integrated utilities prevents “uneconomic new entry.” PJM Transmittal Letter at 76. REC programs, of course, are also overseen by state regulators. PJM fails to explain why state oversight of vertically integrated utilities will prevent costly uneconomic investments, but competitive procurements for renewable energy will not. Recent utility bail-outs of struggling coal plants suggest that state oversight may actually facilitate costly, uneconomic investments.

⁶⁸ *See, e.g.*, N.J.A.C. § 14:8-2.7; MD Code, Pub. Utils. § 7-701; 26 Del. C. § 352.

⁶⁹ A recently passed Virginia law provides utilities with carte blanche to engage in this strategy. *See* SB 966 (2018) (providing that new facilities powered by specified technologies are in the public interest).

⁷⁰ HB 589 (North Carolina)

PJM's proposed disparate treatment ignores recent history. In the face of low PJM prices, utility holding companies have sought to avoid competition by transferring generation assets to one of their utility's ratebase.⁷¹ Under PJM's proposals, such "legacy assets"⁷² that have been bailed out by vertically integrated utilities would receive inflated capacity prices, but a legacy asset compensated for its environmental attributes in a restructured state would not.⁷³

The anti-competitive discrimination against resources that sell RECs or similar products is compounded by PJM's decision to provide inflated rates to resources that receive state tax benefits. In practice, state economic development incentives are only available to natural gas fired power plants. Tax subsidies that target industrial development are typically limited to defined geographic areas, making them unsuitable for wind, solar and other technologies that require specific geography. Panda Power's 1,124 MW Hummel Station plant,⁷⁴ for example, is located in a Keystone Opportunity Zone and receives state and local tax benefits.⁷⁵ PJM's only explanation for excluding these state programs is that the MOPR also employed these exclusions.⁷⁶ Of course, the MOPR also excluded the state environmental programs that PJM now proposes to target.

PJM also offers no explanation for ignoring state retail programs that allow Generation Owners to sell part of their output directly to retail ratepayers through affiliated competitive suppliers or receive above-PJM-market rates from state provider-of-last-resort auctions. PJM fails to distinguish between these "out-of-market revenues" and out-of-market revenues from the sale of state environmental attributes.

⁷¹ See, e.g., *Appalachian Power Co.* 145 FERC ¶ 61,270 (2013) (approving transfer of Mitchell coal plant); *Appalachian Power Co.*, 143 FERC ¶ 61,074 (2013) (approving transfer of John E. Amos coal plant). In approving the transfer of a coal plant to a utility, the West Virginia PSC explained that "[c]ompetitive generation owners, as compared with regulated owners, have different economic motivations that can result in differences in their ability/willingness to make capital investment, approach to capacity markets, and participation in energy markets." Re Monongahela Power Company, 308 P.U.R.4th 415 (W.V.P.S.C. 2013).

⁷² PJM Transmittal Letter at 13–14 (stating that such "assets are receiving a very clear signal from PJM's markets they should either retire, or to the extent they have going-forward value, avail themselves of financial and commercial restructuring under protection of the bankruptcy law if necessary").

⁷³ FRR utilities that do not currently participate in the RPM might opt back in to the capacity construct to receive inflated rates. If they chose to do so, they would receive inflated rates for assets that they had previously shielded from competition.

⁷⁴ Resource Investment Whitepaper at 23.

⁷⁵ Projects in Keystone Opportunity Zones may receive a range of state and local tax benefits. Penn. Dep't of Community and Econ. Development, *Keystone Opportunity Zones* (Apr. 18), <https://dced.pa.gov/download/koz-guidelines-2018/?wpdmdl=56929>. For instance, the Hummel Station plant entered into a 10-year PILOT agreement with the county to freeze real estate taxes at 2014 levels. Marcia Moore, "Tax Exempt Properties: Plant Pays 150K in lieu of taxes," *The Daily Item* (Nov. 19, 2017). According to a Keystone program coordinator, the plant will not pay any state taxes through 2023. The program coordinator could not provide any documentation of that benefit.

⁷⁶ PJM Transmittal Letter at 70.

PJM has elsewhere “acknowledge[d] the widespread existence of subsidies of all sorts that influence PJM market outcomes.”⁷⁷ It would be absurd to require PJM to investigate the effects of each and every state program or regulation that influences market prices, but PJM cannot substantiate its claim that its repricing proposal applies “only [to] those resources that receive subsidies with the most potential to negatively impact auction clearing prices.”⁷⁸ Instead, it appears that PJM is targeting programs that generally benefit market participants who are outmatched in the PJM stakeholder process,⁷⁹ while leaving unharmed state programs and regulatory models that favor incumbents and its preferred class of investors.

PJM candidly discloses that the “ultimate goal”⁸⁰ of engineering higher prices is to provide confidence to private equity investors. PJM explains that the merchant generation business has been “hyper-competitive,”⁸¹ and many publicly traded companies are seeking to shed their merchant assets.⁸² Today, the “overwhelming preponderance” of investment is funded by private equity.⁸³ Private equity investors typically demand a higher rate of return than publicly traded firms.⁸⁴ Financial theory can justify those higher returns when investors shoulder greater risk. However, PJM has recently found that merchant generators are already receiving appropriate returns. In a 2016 whitepaper, PJM concluded that “[g]iven the level of capital being attracted to PJM, it seems *highly implausible* to claim the market is not compensating merchant investors enough for risks they assume.”⁸⁵

“Increased costs can be just and reasonable if the costs are warranted.”⁸⁶ PJM concedes that additional investment is not needed to maintain resource adequacy⁸⁷ and that “the market is providing adequate returns to attract capital.”⁸⁸ Nonetheless, PJM observes that there are “billions of dollars of private equity earmarked for investment in the sector” into the

⁷⁷ Resource Investment Whitepaper at ii.

⁷⁸ PJM Transmittal Letter at 80.

⁷⁹ See Christina Simeone, University of Pennsylvania Kleinman Center for Energy Policy, “PJM Governance: Can Reforms Improve Outcomes (2017), <https://kleinmanenergy.upenn.edu/sites/default/files/PJM%20Governance%20Reforms.pdf>, at 35 (“When it comes to sector voting, renewable interests are likely to be dominated by traditional generation interests); at 38 (showing that in 2015, over 77 percent of the generation resources needed to meet PJM’s peak were controlled, in full or in part, by only 10 companies).

⁸⁰ PJM Transmittal Letter at 1; *id.* at 12; *id.* at 21.

⁸¹ *Id.* at 12.

⁸² *Id.* at 13.

⁸³ *Id.* at 9–13 (“[A] new type of Generation Owner has emerged . . . These merchants are private concerns, not capitalized in part by public equity markets, but by private equity . . . Within this class of merchant entry over the last ten years, the overwhelming preponderance has been funded by private equity . . .”).

⁸⁴ See *PJM Interconnection*, 149 FERC ¶ 61,183 at PP 76–84 (2014).

⁸⁵ Resource Investment Whitepaper at 24 (emphasis added); *id.* at 20 (“The alpha results suggest that merchant firms are generating returns equal to their expected returns.”).

⁸⁶ *Advanced Energy Management Alliance*, 860 F.3d at 662.

⁸⁷ PJM Transmittal Letter at 11.

⁸⁸ Resource Investment Whitepaper at 29.

market, and that prices are currently too low to drive that money into the market.⁸⁹ Regardless of the market fundamentals, PJM is keen to motivate private equity investors to either bail out existing legacy assets⁹⁰ or construct new natural gas fired plants. The Commission need not accept that as just and reasonable basis for raising rates.

PJM also claims that price inflation is necessary to “honor” each of the Commission’s “first principles” of capacity rate regulation.⁹¹ In other words, targeting state policies that supposedly have price-suppressive effects is justified in its own right to restore prices that are consistent with a “workably competitive” market. The rescinded MOPR exemption that PJM cites as precedent targeted “efficient resources to suppress capacity prices,”⁹² and the Commission can choose not to extend that mitigation authority to resources that it has previously determined “are a poor choice” for suppressing capacity prices.⁹³ No court decision or Commission order compels the Commission to mitigate offers from resources that have a theoretical and unquantified impact on capacity rates, as PJM requests.

Conclusion

Recognizing that states select resources based on environmental factors, seven years ago the Commission invited PJM to submit a proposal that “account[s] for resource attributes that reflect broader objectives than three-year forward reliability.”⁹⁴ PJM now concedes that there are “a daunting number of practical, legal, and political obstacles” to “such [a] theoretical approach”⁹⁵ and instead proposes to isolate from the market resources that sell renewable energy credits or other environmental attributes. The Commission should send PJM back to the drawing board. PJM provides insufficient justification for disrupting a program of cooperative federalism.

Respectfully Submitted,

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⁸⁹ PJM Transmittal Letter at 13.

⁹⁰ *Id.*

⁹¹ PJM Transmittal Letter at 45–46.

⁹² *PJM Interconnection*, 135 FERC ¶ 61,022 at P 153 (2011).

⁹³ *Id.* at P 153, *reh’g denied* 137 FERC ¶ 61,145 at PP 110–111 (2011).

⁹⁴ *PJM Interconnection*, 137 FERC ¶ 61,145 at P 90 (2011).

⁹⁵ PJM Transmittal Letter at 55.