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**

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I appreciate the opportunity to participate in today's Technical Conference regarding the interplay between State policies and the Commission-jurisdictional wholesale markets. My NRG colleague, Mr. Peter Fuller, has also filed comments in this proceeding and these comments meant to build upon the items he presented.

I. Competitive Markets are the Best Way to Meet State Mandates.

The uniform American experience is that competition drives down prices, increases quality of service, and encourages technical innovation. The energy industry is not exempt from the laws of economics. Indeed, the very questions posed by today's conversation – whether consumer welfare increases more through a vibrant competitive market or through prescriptive state mandates – would be foreign to most other sectors of the economy. Fortunately, Congress, multiple presidential administrations, and this Commission under the Chairmanship of commissioners of both parties have all declared competitive markets to be in the national interest.

Competitive power markets have proven effective at delivering reliability at low prices. The cost of energy and capacity are the lowest they have been since restructuring (even as transmission & distribution costs continue to grow unabated). Innovations in turbine technology led directly to more efficient use of natural gas. Forced outage rates are down versus pre-competition levels. Renewables costs are dropping. And a burgeoning demand response industry accounts for almost 10% of the supply stack in such key markets as PJM. These and other innovations were largely driven by *shareholder* investment of "at-risk" dollars with *no recourse* to captive ratepayers.

Competitive markets are not "broken" simply because they do not currently price carbon or other environmental externalities or attributes. Nor are markets broken simply because certain classes of generators make less today than they did a few years ago. Instead of adopting the narrative that markets are failing, we should ask how to adapt competitive markets to achieve State goals in a least-cost fashion. Specifically:

> "What set of market rules do we need to take advantage of competitive markets to drive down the costs of achieving State goals and ensure that consumers receive the maximum environmental benefits at the lowest possible price?"

> "How do we design our competitive markets to achieve State environmental goals on an equal basis with reliability and lowest possible cost?"

Accomplishing legitimate State goals (at just and reasonable prices) should be a core component of the cooperative federalism enshrined in the Federal Power Act. *See FERC v. EPSA*, 136 S. Ct. 760, 779-80 (2016). States are increasingly incorporating carbon, job, tax, and other externalities into their energy policies. In isolated cases, States have adopted jobs and economic development programs which "mix and match" environmental and economic goals in a deliberate effort to avoid Commission jurisdiction. Moving forward, we need to carefully distinguish between State programs that "aim at" or "target" the wholesale market, which are likely preempted, from more benign State initiatives.

Meeting these State goals will involve the investment of billions in new capital into renewables and other innovative technologies over the next decade. Achieving these goals through FERC's competitive markets will be faster and cheaper than relying on individual state efforts. As we work on designing these next-generation energy markets, the Commission must act to protect the competitive markets during the tumultuous transition to this new world. Otherwise, the competitive market experiment will likely fail, investment capital will become more expensive or dry up entirely, and consumer prices – for both renewable and conventional generation – will increase unnecessarily.

II. Sustainable Market Structures are Key to Driving Private Investment.

The next thirty years will see an investment "super-cycle" in the energy sector as older resources retire and are replaced with lower emitting, more distributed, more controllable, and cleaner technologies. To succeed in these efforts, the power sector must be ruthlessly efficient in attracting and deploying capital. We have a stark choice:

> Option #1: Allow individual States to pick low- and no-carbon winners and losers outside the competitive markets and pass those costs through to retail ratepayers. This approach assumes that ratepayer capital will be sufficient to fund our deep de-carbonization efforts (without harming economic expansion) and that ratepayers have the requisite capacity to absorb increased cost and risk.
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> Option #2: Create a long-term sustainable market structure that attracts private *shareholder* dollars into the energy sector with the promise of a reasonable opportunity to compete to earn a reasonable return on those investments. This public-private collaborative approach drives down costs and husbands scarce ratepayer dollars.

The benefits of Option #2 are compelling. *First*, each dollar of public funds capital committed to a successful competitive market structure leverages multiple dollars of private investment. The Green Bank in New York, for example, reports that it leverages four dollars of private capital for every one dollar of public funds. This multiplicative effect is critical to raising the private capital we need to meet our long-term carbon reduction goals at just and reasonable rates.

Second, deploying "at-risk" capital into the next generation of energy investments ensures that shareholders – not ratepayers – bear technology and operational risk associated with these

innovative technologies. This minimizes the risk that ratepayers will be asked to fund yet another round of stranded cost recovery or otherwise bail out poor investment decisions by integrated utilities or regulators.

Third, the increasing availability of distributed energy resources and mass-market demand response products means that the utility business model is facing real competition for the first time. The presence of customer-facing alternatives effectively institutes a 'cap' on the prices utilities can charge. In response to such competition, utilities should decrease – not increase – ratebase. Utility investments should target regulated monopoly delivery and 'platform' functions, scaled appropriately so not to over-burden ratepayers with projects that private capital is willing and able to finance.

Finally, investment of "at risk" dollars is the best means of driving innovation in the energy sector. Climate change is at its core an innovation challenge, since "deep decarbonization" will require radically cheaper clean energy technologies. So if we are serious about carbon, we must also be serious about using competitive markets to drive technological innovation.

III. The Commission has a Statutory Obligation to Ensure that Consumers Pay Just and Reasonable Rates.

Congress gave the Commission exclusive jurisdiction over sales of electric energy for resale, as well as programs "affecting" or "in connection with" those sales. As the *EPSA* Court explained, the Commission's statutory commandment to ensure just and reasonable rates is not optional:

> If FERC sees a violation of [the just and reasonable] standard, it must take remedial action. . . . That means FERC has the authority—and, indeed, the duty—to ensure that rules or practices affecting wholesale rates are just and reasonable.

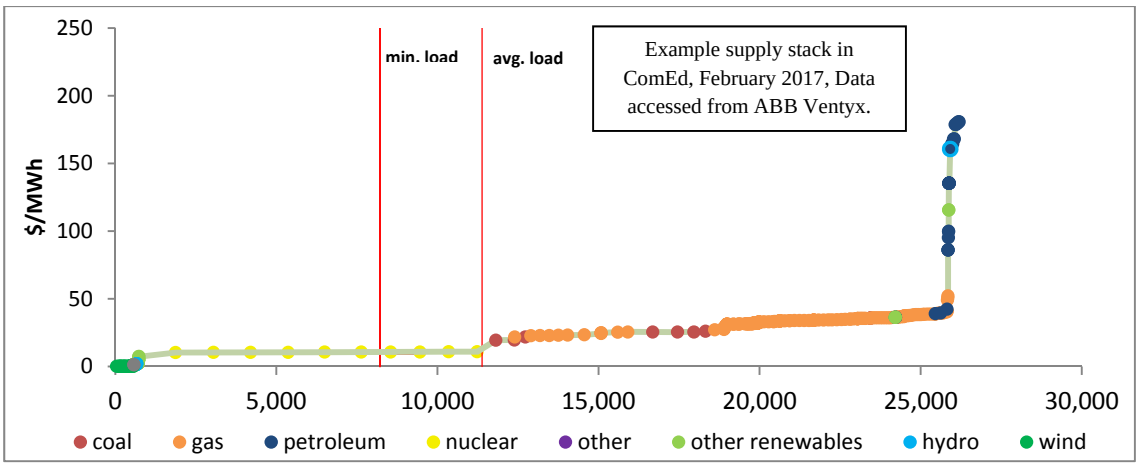
The Commission has thus far deferred asking whether captive ratepayers are paying just and reasonable rates in connection with most State subsidy programs. This hands-off approach rightly allowed States to experiment on the edges of the wholesale market with a variety of new programs and to avoid over-burdening these fledgling initiatives with federal intervention. As the Nation's energy mix evolves, however, the manner in which the Commission fulfills its statutory obligations must evolve along with the grid realities.

It is easy to envision cases that would test the extent of the Federal Power Act's cooperative federalism approach. What would happen, for example, if a State under FERC's jurisdiction adopted a 100% renewable portfolio standard? Fortunately, the legal challenges to date have focused on more obvious State intrusions where a State picks politically favored entity to receive lucrative long-term contracts without ever demonstrating that the resulting rates are just and reasonable, by, for example, conducting a competitive solicitation open to all parties. Clearly, the answer cannot be that FERC is powerless to prevent this type of consumer abuse.

No example of ratepayer waste is more stark than the nuclear bailouts taking place in New York and Illinois. Between the two states, ratepayers are being asked to spend more than $10 billion over the next decade on keeping economically inefficient nuclear plants operating in the wholesale market. Indeed, the Illinois legislature and the New York Public Service Commission

were exceptionally clear about their desire to "aim at" and "target" wholesale market outcomes with which are unhappy when they passed their respective nuclear bailout programs. Both states implemented these programs without ever testing these investments in order to determine whether consumers could have received more carbon "bang-for-their-buck" elsewhere.[1] As a result of these programs, citizens in Illinois and New York are currently paying unjust and unreasonable rates, which were declared unlawful by Congress in the Federal Power Act.

Furthermore, size does matter. The nuclear bailouts programs represent massive interventions in the wholesale market, and the law does not require the Commission to accommodate programs that are at odds with its preferred competitive market framework.[2] New York currently receives approximately one-third of its energy from nuclear resources and its bailout scheme effectively re-regulates this portion of the market. In Illinois, the potential to undermine the wholesale market is even greater, since nuclear units make up the vast majority of the dispatch stack in Illinois on a normal day, as shown in Figure 1:



One of the major challenges with the existing State programs is that it is difficult to articulate a "limiting principle" as to what type of State action is permissible before it impermissibly intrudes upon the Commission's exclusive jurisdiction. However, the Commission has made such difficult jurisdictional cuts before. The Supreme Court once famously posited that the Commission may have jurisdiction under the transmission prong of its jurisdiction "down to the toaster." *Conn. Light & Power Co. v. FPC*, 324 U.S. 515, 529-530 (1945). The Commission has wisely never asserted its jurisdiction that far, instead relying on rule-of-reason tests, such as the

[1]The evidence is compelling that this money could have been better spent. For $3.5 billion – or approximately half the price of the bailout in New York, the State could have purchased enough renewables to replace the output of all of its at-risk nuclear fleet with 100% new renewable power. Additionally, New York's Independent Market Monitor found that a new combined cycle on Long Island is a far cheaper means of reducing carbon in New York than the nuclear bailout.

[2] States may enact environmental protection measures, but any such law must yield "if it interferes with the methods" prescribed by federal law. *Int'l Paper Co. v. Ouellette*, 479 U.S. 481, 494 (1987).

seven-factor test for differentiating distribution lines from transmission lines, to determine whether specific grid edge facilities should fall under FERC jurisdiction.[3]

Clearly, a similar effort to delineate how State programs are harmonized with competitive markets is needed here. Wherever the line is eventually drawn, there clearly must be a line if the Federal Power Act is to have meaning.

IV. The Commission Can Help States "Achieve" Their Clean Energy Goals – at Less Cost.

Mr. Fuller's testimony lays out NRG's "Triple A" approach to energy markets (accommodate, achieve, and adapt) and this section of my testimony sketches out how our Nation can best '***achieve***' state clean energy objectives through ISO markets. Nothing in this testimony is meant to diminish the authority of States to mandate preferred environmental outcomes. States can, and should, dictate the emissions profile of the power that their citizens consume, within the constraints laid out by the Federal Power Act and the Supremacy Clause of the U.S. Constitution.

However, the Commission also has a clear statutory role in mandating that the resulting rates are just and reasonable – both for buyers and sellers. The best way for the Commission to meet this statutory commandment is to apply competitive principles and incorporate the environmental targets set by the States into the relevant ISO/RTO market.

NRG sees competition for long-term renewables contracts centrally cleared through an ISO-run market as a promising option for achieving long-term decarbonization at the lowest possible cost to consumers.[4] Even more promising are the coordinated forward auctions for renewable *and* conventional energy recently floated during New England's IMAPP process. Such initiatives co-optimize the procurement of renewable and conventional capacity, resulting in a total fuel mix that delivers the State's preferred environmental goals at the least possible cost, while also ensuring that reliability is maintained. States would achieve all of their environmental goals and consumers would save money in the process.

Strong Commission leadership is necessary, however, if we are going to break the log-jam that has threatened progress in the northeast RTOs and save competitive markets. States are (understandably) reluctant to stall progress on meeting environmental goals. This leaves an opening for the Commission to come in and direct each of its ISO/RTO markets to set forth a comprehensive plan to integrate State goals into its wholesale market outcomes in a sustainable manner. Unless the Commission mandates such a process – by a date certain – I fear that States will continue to pursue carbon mandates outside of the organized markets, and society will be deprived of the benefits of competitive markets.

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[3] *See Miss. Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354, 374 (1988) ("States may not regulate in areas where FERC has properly exercised its jurisdiction to determine just and reasonable wholesale rates or to insure that agreements affecting wholesale rates are reasonable.")

[4] State or regional carbon taxes, such as A.B. 32 in California or the Regional Green House Gas Initiative ("RGGI") in the east, also internalize the cost of carbon emissions on a non-discriminatory basis, although they may not send the same long-term investment signals for new renewable generation.