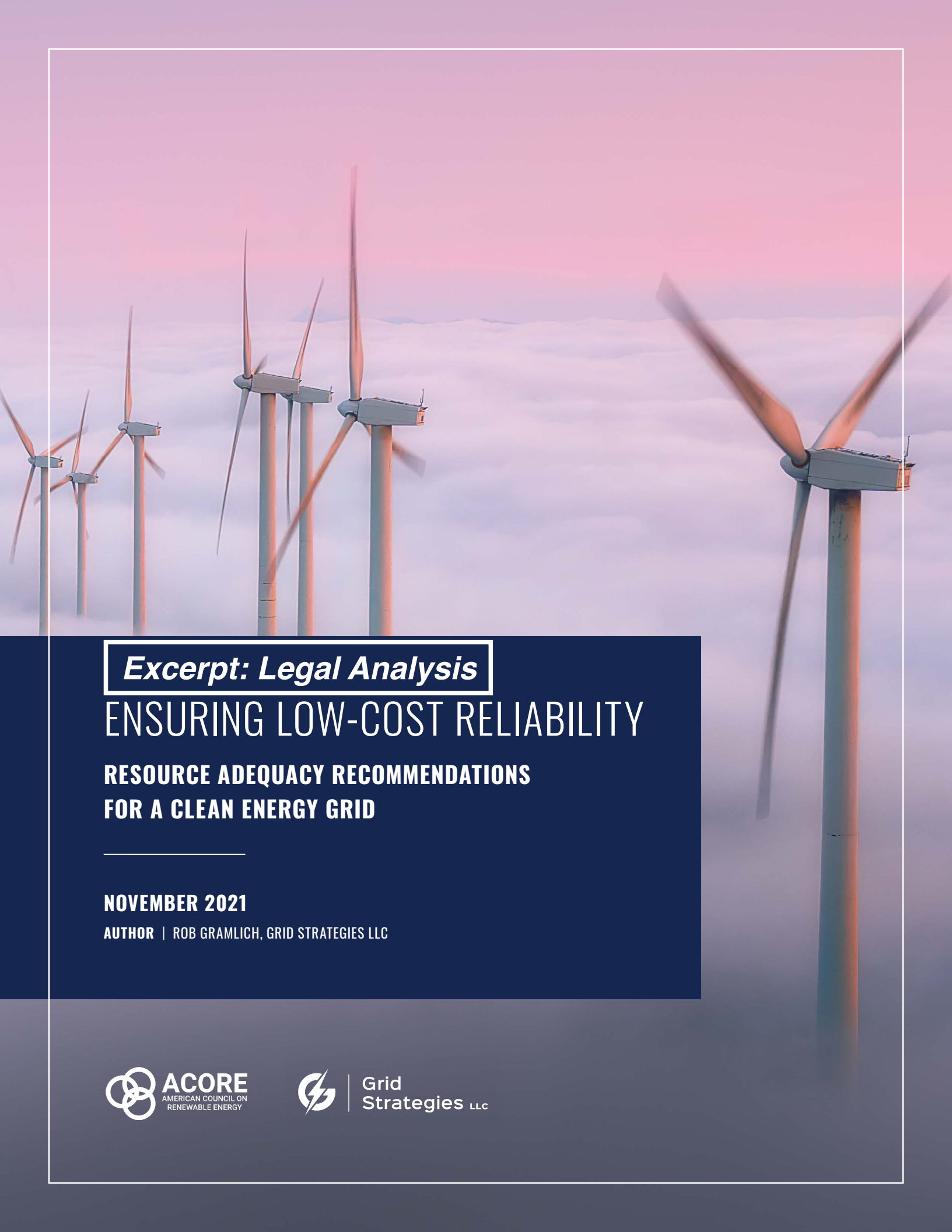


A photograph of several wind turbines in a field, with the sky transitioning from a soft pink to a pale blue, suggesting a sunset or sunrise. The turbines are silhouetted against the bright sky, and their blades are in motion, creating a slight blur.

Excerpt: Legal Analysis

ENSURING LOW-COST RELIABILITY

RESOURCE ADEQUACY RECOMMENDATIONS FOR A CLEAN ENERGY GRID

NOVEMBER 2021

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Grid
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APPENDIX A

RESOURCE ADEQUACY FOR A CLEAN ENERGY GRID

LEGAL ANALYSIS

An Interview with Jonathan D. Schneider, Partner, Stinson LLP⁴⁵

This memorandum considers a series of questions related to state and federal jurisdiction over resource adequacy requirements.



November 2021

This memorandum considers a series of questions related to state and federal jurisdiction over resource adequacy requirements,⁴⁶ including whether the Federal Energy Regulatory Commission (FERC) can mandate participation in capacity markets. The memorandum also considers the extent of jurisdiction under Federal Power Act (FPA) section 215 over electric reliability granted to FERC and the North American Electric Reliability Corporation (NERC). Finally, the memorandum considers whether FERC has authority over the environmental attributes of low-carbon resources unbundled from electric sales, and whether the answer to that may change if the procurement and sale of generating capacity and environmental attributes are co-optimized in a platform overseen by FERC.

The memorandum concludes:

- (1) State-based regulatory authorities have jurisdiction reserved under the FPA to set the level and composition of generation to serve load. Outside ISO/RTO regions, this authority has been exercised without federal interference. Inside ISO/RTO regions, state-based authority may not be exercised with the aim of affecting FERC-regulated wholesale market prices.
- (2) In a non-RTO environment, FERC has no obvious basis for exercising authority to impose a resource adequacy requirement, though it may have authority to oversee the administration of a voluntary resource adequacy framework agreed to by market participants.
- (3) In ISO/RTO organized wholesale markets, precedent holds that FERC has the authority to require LSEs to pay financial penalties if they do not meet resource adequacy requirements as a condition of participation in wholesale markets.
- (4) FERC may have the authority to compel participation in capacity markets, though the Commission has held that the exercise of this authority depends on circumstances it has not

⁴⁵ <https://www.stinson.com/people-JonathanSchneider>

⁴⁶ For purposes of this analysis, resource adequacy is taken to refer to a requirement that LSEs demonstrate that they have a specified level of generating capacity available to the market as a condition of their participation.

found evident.

(5) FERC's and NERC's authority over electric reliability under FPA section 215 does not support NERC's or FERC's ability to impose a resource adequacy requirement.

(6) The environmental attributes of electric generating resource sold on an unbundled basis are outside FERC jurisdiction. FERC may have ancillary authority over these attributes if they are bundled with electric sales undertaken under FERC's jurisdiction.

1. What is the scope of state-based authority over resource adequacy requirements?

In all markets, whether outside an ISO/RTO setting or within, state-based authorities (including municipal utilities and non-FERC jurisdictional cooperative utilities) have the authority to ensure that sufficient generating capacity is built to meet the needs of retail load, and to stipulate to the nature of that generation. State agencies are generally given authority under state law over measures needed to ensure safe and adequate service. That authority includes oversight of the adequacy of generation to serve load.⁴⁷ In a traditional, vertically integrated utility environment, state public service commissions and non-FERC-jurisdictional utilities have relatively unfettered authority in this area.

When acting within the ISO/RTO environment, state-based authority over resource adequacy is constrained in two ways. First, state authorities may not exercise their authority with the aim of affecting FERC-regulated wholesale market prices. According to the Supreme Court in *Hughes v. Talen Energy Marketing, LLC*, 136 S. Ct. 1288 (2016),⁴⁸ this was the objective of a Maryland-supported program assuring participating generators revenue at a guaranteed level, so long as they participated in PJM's FERC-jurisdictional capacity market. The Court expressly withheld judgment with respect to state-based measures "untethered to a generator's wholesale market participation, such as tax incentives, land grants, direct subsidies, construction of state-owned generation facilities, or re-regulation of the energy sector."⁴⁹

Second, while FERC cannot prohibit state and local authorities from directing investments in designated generating resources, its rules governing the eligibility of these resources to participate in mandatory capacity markets, and penalties associated with the failure to do so, trigger concern that states will be required effectively to pay twice for generating capacity, once through the state mandate, and another time through FERC-administered penalties. The court in *N.J. Bd. of Pub. Utils. v. FERC*⁵⁰ held this to be permissible, rejecting the argument made by state authorities that this approach interfered with the provision in FPA section 201(b)(1), prohibiting FERC from exercising authority over generating facilities.

2. What authority does FERC have over resource adequacy outside the ISO/RTO environment?

FERC has limited authority to direct load serving entities to comply with a resource adequacy

47 See *Pacific Gas & Elec. Co. v. State Energy Resources Conservation and Development Comm'n*, 461 U.S. 190, 205 (1983) ("[n]eed for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States.").

48 136 S. Ct. 1288 (2016).

49 *Id.* at 1299.

50 *N.J. Bd. of Pub. Utils. v. FERC*, 744 F.3d 74 (3d Cir. 2014) (NJ Board).

requirement outside an ISO/RTO region. FERC's authority under FPA sections 205 and 206 to address rules, regulations and practices "affecting" wholesale market prices (discussed more extensively below in the ISO/RTO setting) has relatively little practical impact in the non-ISO/RTO environment, where wholesale market activity and FERC oversight is somewhat limited. Further, FPA section 201(b)(1) provides that FERC does not have jurisdiction "over facilities used for the generation of electric energy."

With that said, where load serving entities and others voluntarily choose to enter into an agreement to bind one another to specified resource adequacy requirements, FERC may have authority over the contractual mechanism, and possibly the relevant administrative entity. FPA section 205 and 206, authorizing the Commission to regulate practices affecting wholesale rates, may carry the Commission as far as oversight of these agreements and activities. This is the working conclusion drawn by participants in the Northwest Power Pool's current effort to establish a voluntary resource adequacy framework among regional load serving entities.⁵¹

3. What authority does FERC have over resource adequacy requirements within the ISO/RTO environment?

FERC's exercise of authority to compel a resource adequacy requirement in an organized market through the imposition of penalties on load serving entities (LSEs) for failure to participate has been upheld in the courts. Precedent also supports the position that FERC may have the authority to direct the creation of a capacity market in the ISO/RTO setting.

FERC's authority to approve financial penalties designed to incentivize the procurement of capacity in order to meet a resource adequacy requirement by LSEs participating in an organized market was upheld in *Ct. Dep't of Public Utility Control v. FERC*.⁵² There, the Commission's approval of ISO-NE's Installed Capacity Requirement (IRC) was challenged by the Connecticut DPUC on the ground that it impinged on state authority over generating facilities reserved to the states under section 201(b) of the FPA. The court rejected Petitioners' argument, holding that the FPA's prohibition against FERC regulation of generating facilities "says nothing about its power to review the capacity requirements that an entity like ISO-NE imposes on member LSE's."⁵³ The court relied on its 1978 decision in *Municipalities of Groton v. FERC*⁵⁴ for the proposition that a capacity deficiency charge aimed at eliciting sufficient generation in the wholesale market involves a "practice affecting rates" under sections 205 and 206 of the FPA.⁵⁵ Accordingly, the court held that "[i]t is sufficient for jurisdictional purposes that the deficiency charge affects the fee that a participant pays for power and reserve service, irrespective of the objective underlying the charge."⁵⁶ Though conceding that FERC's statutory authority may be read more narrowly, the court further held it was far too late in the development of related case law to argue otherwise. According to the court:⁵⁷

51 See: <https://www.nwpp.org/resources/2021-nwpp-ra-program-detailed-design>.

52 *Ct. Dep't of Public Utility Control v. FERC*, 569 F.3d 477 (D.C. Cir. 2009) ("CPUC").

53 *Ibid.*, p. 483.

54 *Municipalities of Groton v. FERC*, 587 F.2d 1296 (D.C. Cir. 1978).

55 *Ct. Dep't of Public Utility Control v. FERC*, 569 F.3d 477, p. 484 (D.C. Cir. 2009).

56 *Ibid.*, p. 482.

57 *Ibid.*, p. 483.

[E]ven if these statutory provisions could be read to prohibit the Commission from requiring LSEs to make adequate capacity purchases, and even if that is what the Commission is doing, this particular camel has long since entered – indeed, ransacked – the tent. Again, three decades ago in *Municipalities of Groton*, we sustained the Commission’s assertion of jurisdiction over ‘deficiency charges’ NEPOOL imposed on member LSEs that came up short on their capacity requirements.

Addressing what authority is left to the states (and outside FERC control), the court observed that the IRC does not “actually ‘require’ anyone to ‘install any new ‘capacity at all’” and that “[s]tate and municipal authorities retain the right to forbid new entrants from providing new capacity, to require retirement of existing generators, to limit new construction to more expensive, environmentally friendly units, or to take any other action in their role as regulators of generation facilities without direct interference from the Commission.”⁵⁸

It is worth emphasizing that the Commission’s authority to address practices “affecting rates” under FPA sections 205 and 206 has been construed broadly. In *South Carolina Pub. Serv. Authority v. FERC*,⁵⁹ this authority was held sufficient to enable FERC to compel utilities to enter into contracts with transmission developers for the construction of new transmission facilities approved through joint regional planning processes. And in *FERC v. EPSA*,⁶⁰ the Supreme Court authority held the Commission’s authority sufficient to support a rule compelling ISOs/RTO to modify their tariffs in order to enable demand response providers to bid their service into organized markets, on the ground that the rule is a “practice directly affect[ing] the wholesale rate.”⁶¹

Consistent with the decision in *CPUC*, the Commission has approved penalties for failure to meet capacity requirements in several other ISO/RTO proceedings.⁶²

Efforts by ISO/RTO members to exempt themselves from ISO/RTO RA requirements through self-supply or withdrawal of resources and load through such programs as PJM’s Fixed Resource Requirement have been restricted or rejected by FERC, motivating certain states to consider withdrawing from the ISO/RTO framework altogether.

4. Does FERC have the authority to approve and to mandate capacity markets?

The Commission has long held that it has the authority to approve proposed mandatory capacity markets, and there is support for the position that it has authority to mandate them. The Commission approved ISO-NE’s proposed capacity market in *Devon Power, LLC*⁶³ in connection with ISO-NE’s market (“the Commission initiated these Section 206 proceedings... in response to the compensation problems faced by generating resources that are needed for reliability but could not obtain sufficient revenues in the markets to continue operation”).

⁵⁸ *Ibid.*, p. 481.

⁵⁹ *South Carolina Pub. Serv. Authority v. FERC*, 762 F.3d 41 (D.C. Cir. 2014).

⁶⁰ *FERC v. EPSA*, 136 S. Ct. 760 (2016).

⁶¹ *Ibid.*, p. 774.

⁶² See CAISO, 162 FERC ¶ 61,042, at P 30 (2018); MISO, 162 FERC ¶ 61,176 (2018); MISO, 125 FERC ¶ 61,062, at ¶¶ 126-144 (2008), order on reh’g and compliance, 126 FERC ¶ 61,144 (2009), order on clarification, 135 FERC ¶ 61,081 (2011). SPP, 164 FERC ¶ 61,092 (2018) (approving SPP Tariff revisions to implement a resource adequacy requirement).

⁶³ *Devon Power, LLC*, 115 FERC ¶ 61,340, pp. 62.

And it did so in PJM’s case, also holding that the violation of reliability criteria warranted the finding that the existing rate structure was unjust and unreasonable, and that PJM’s proposed “Reliability Pricing Model” was needed.⁶⁴

Judicial support for FERC’s exercise of this authority is found in *N.J. Bd. of Pub. Utils. v. FERC*,⁶⁵ in which the court rejected challenges to PJM’s MOPR, as applied in PJM’s mandatory capacity market, in terms that strongly suggesting that FERC has the authority to mandate a capacity market. The court rejected the argument that FERC’s elimination of the exemption from application of the MOPR for state-mandated resources violated the FPA section 201(b) prohibition against FERC regulation of generating facilities. Adopting the same approach taken in *CPUC*, the court held that removal of the state-mandate from exemption under the MOPR involved a rule “affecting the rates” for wholesale sales.⁶⁶

Addressing the argument that the decision unlawfully treads on jurisdiction reserved to state authority over generating facilities, the court held that the elimination of the exemption had no effect other than financial on state-based decisions regarding generation. Rejecting the claim that “FERC is preventing New Jersey from using the resources it has chosen to promote,” the court held that “New Jersey and Maryland are free to make their own decisions regarding how to satisfy their capacity needs, but they ‘will appropriately bear the costs of [those] decision[s],’ including possibly having to pay twice for capacity.”⁶⁷ The court relied heavily on the decision in *CPUC*, *supra*, for the propositions that rules governing participation in FERC organized markets are within the Commission’s “affecting wholesale rates” authority, and that financial penalties assessed to state supported resources do not amount to the regulation of generating facilities.⁶⁸

More recently, in *CSA La Paloma LLC v. CAISO*,⁶⁹ *Order Denying Reh’g*,⁷⁰ the Commission rejected La Paloma’s request for an order compelling CAISO to implement a capacity market, finding that La Paloma failed to show that CAISO’s existing resource adequacy requirement was unjust and unreasonable, though the Commission did not question its authority to issue an order in other circumstances. More specifically, the Commission found that La Paloma failed to demonstrate: (1) that inadequate revenue for competitive generating resources in itself calls for a change to the tariff; (2) that inadequate revenue would result in premature plant retirements and a generation shortfall; and (3) that reliability violations would result from the status quo. The Commission further found no support for La Paloma’s argument that the status quo discriminated in favor of renewable resources.⁷¹

In *La Paloma*, FERC further noted as a general matter that “it has not required a centralized capacity market as part of a just and reasonable market design,” citing its earlier decision in

64 PJM Interconnection, LLC, 115 FERC ¶ 61,079 (“PJM RPM Order”), order denying reh’g and approving settlement, 117 FERC ¶ 61,331 (2006) (“PJM RPM Settlement Order”), order on reh’g, 119 FERC ¶ 61,318 (2007).

65 *N.J. Bd. of Pub. Utils. v. FERC*, *supra*.

66 *Ibid.*, p. 96.

67 *Ibid.*, at 97 (citations omitted). It is worth noting that FERC extended this approach in *Calpine v. PJM Interconnection, LLC*, 169 FERC ¶ 61,239 (2019) to include in the definition of subsidies calling for offsets through the MOPR a variety of state-based programs supporting generation, over the vigorous dissent of now-Chairman Glick, arguing that the order unlawfully intruded in state-based jurisdiction over generating facilities. The order is on appeal, and may yet be revisited at FERC.

68 *Ibid.*, pp. 96-97.

69 *CSA La Paloma LLC v. CAISO*, 165 FERC ¶ 61,148 (2018) (*La Paloma*).

70 *Order Denying Reh’g*, 169 FERC ¶ 61,045 (2019).

71 *CSA La Paloma LLC v. CAISO*, 165 FERC ¶ 61,148, pp. 70-77, (2018).

MISO,⁷² rejecting a request to impose a mandatory centralized capacity market with a sloped demand curve and MOPR.

Taken together, the courts' decisions in NJ Board and CPUC, and the Commission's decisions in *La Paloma* and *MISO*, strongly suggest that a defense against a proposal for the creation of capacity markets is likeliest to succeed at FERC if grounded in the case-specific circumstances of the proposal, and the proponents' failure to demonstrate that inadequate revenues threaten the vitality of the wholesale market and system reliability. This was the tack successfully taken by CAISO in responding to *La Paloma's* complaint. Critically, CAISO effectively distinguished the Commission's earlier decisions adopting capacity markets in PJM⁷³ and ISO-NE⁷⁴ cases, on the ground that *La Paloma* failed to demonstrate the reliability or rate problems the Commission reached out to address in those cases.⁷⁵ For example, if resource adequacy is addressed sufficiently through other mechanisms such as state policy, then the Commission has little basis to find reliability or rate problems. Of course, those determinations can be subjective and one sitting Commissioner, James Danly, has raised concerns that California's market has reliability and rate problems.⁷⁶ Nonetheless, it is worth emphasizing that the *La Paloma* and *MISO* decisions suggest that as of this date there is little appetite at FERC to impose new capacity markets on regions that do not have them.

5. Does FPA section 215 (reliability regulation) empower NERC or FERC to implement a resource adequacy requirement?

Probably not. As discussed above, resource adequacy proposals at FERC (including capacity market proposals), and the Commission's decisions approving them, have been consistently supported by reference to the need to support system reliability. But those references have generally been to a broader conception of reliability than contemplated by section 215 of the FPA.

The authority invested in FERC and NERC under FPA section 215 is narrow, as is the definition of reliability concerns addressed by the statute and the facilities (Bulk-Power System) to which the provision applies. First, as to FERC authority, section 215(b) of the statute provides the Commission with jurisdiction over the Electric Reliability Organization (NERC), regional entities and users, owners and operators of the bulk power system only "for purposes of approving reliability standards established under this section and enforcing compliance with this section." The section does not, despite frequent contrary assertions,⁷⁷ provide FERC with general authority over grid reliability. The agency has authority under FPA section 215 over the promulgation of reliability standards and their enforcement, and is not given any other plenary authority.

72 *MISO*, 162 FERC ¶ 61,176 (2018).

73 PJM RPM Settlement Order, *supra*.

74 *Devon Power*, *supra*.

75 See *Answer of California Independent System Operator Corporation to Complaint*, pp. 34-42, August 24, 2018.

76 "...given the experience in CAISO, it is necessary for us to ask the question as to whether or not in our oversight responsibilities it is necessary to inquire as to the fitness of the tariff they currently have... when utilities have tariffs that are failing to provide through the market mechanisms that they are operating, the benefits and the resource adequacy that we want them to, we have to look into whether or not those tariffs are still J&R." FERC, *Open Meeting December 17, 2020*, Transcript, pp. 41-42, Commissioner Danly statement in support of a show cause order which was voted down in a 2-1 vote.

77 In its complaint, *La Paloma*, e.g., asserted that FERC has general authority over the "reliability of the bulk power system."

Second, as to the scope of reliability concerns, section 215 specifies that the ERO's responsibilities are limited to promulgating and enforcing reliability standards aimed at the "reliable operation" of the bulk-power system. The "reliable operation" of the grid is defined in FPA section 215(a)(4) to mean:

operating the elements of the bulk-power system within equipment and electric system thermal, voltage, and stability limits so that instability, uncontrolled separation, or cascading failures of such system will not occur as a result of a sudden disturbance, including a cybersecurity incident, or unanticipated failure of system elements.

This definition focuses on system instability, a matter not necessarily implicated when considering RA, which assesses the sufficiency of energy to serve load. It is also worth emphasizing that FPA section 215(i)(2) specifies that FPA section 215 "does not authorize the ERO [NERC] or the Commission to order the construction of additional generation...or to set and enforce compliance with standards for adequacy or safety of electric facilities or services."

FPA § 215 does require the ERO [NERC] to "conduct periodic assessments of the reliability and adequacy of the bulk-power system in North America."⁷⁸ Under this authority, NERC issues annual assessments⁷⁹ of the adequacy of electricity supplies for the upcoming summer and winter peak demand periods, as well as the long-term (10-year) period. Similarly, ReliabilityFirst (a NERC "regional entity") relied on this authority to require "Planning Coordinators" (e.g., PJM) to perform an annual resource adequacy analysis.⁸⁰ FERC approved this requirement by ReliabilityFirst in 2011.⁸¹ FERC held that the requirement "does not intrude on the state's decisional authority with respect to building or acquisition of assets or capacity to meet resource adequacy needs." This order was not challenged or reviewed by a court.

6. Would a FERC-administered capacity market which co-optimizes resource adequacy and environmental attributes subject environmental attributes to FERC jurisdiction?

Quite possibly. Among the proposals for capacity market reform discussed in this paper are those that call for ISOs/RTOs to assume authority over a market for combined capacity and the participating generators' environmental attributes (tradeable renewable energy certificates, or RECs, or Clean Energy Attribute Credits). This has raised the question whether a "co-optimized" market of this nature may extend FERC authority over the REC market that may not otherwise exist.

FERC has held that RECs are products of state law, and generally outside the Commission's authority. In *American Ref-Fuel Co, et al.*,⁸² the Commission granted Petitioners' request for a declaratory order determining that Qualifying Facility (QF) remuneration under PURPA's avoided cost standard does not provide the purchasing utility with a right to the RECs associated with the QF's production of power.⁸³ The Commission extended this principle

⁷⁸ FPA § 215(g).

⁷⁹ North American Electric Reliability Corporation, "Reliability Assessments," (n.d.).

⁸⁰ North American Electric Reliability Corporation, *Standard BAL-502-RF-03*, (n.d.).

⁸¹ The current, slightly modified, version of this requirement was approved here: FERC, *Letter Regarding Petition of the North American Electric Reliability Corporation and ReliabilityFirst Corporation for Approval of Proposed Regional Reliability Standard BAL-502-RF-03*, October 2017.

⁸² *American Ref-Fuel Co, et al.*, 102 FERC ¶ 61,004 (2003).

⁸³ *Ibid.*, p. 18.

in *WSPP, Inc.*,⁸⁴ holding that “unbundled REC transactions fall outside the Commission’s jurisdiction under sections 201, 205 and 206 of the FPA” on the ground that they are neither the transmission nor sale of energy.⁸⁵ Nor, on an unbundled basis, do they “affect” or take place “in connection with” wholesale sales in a manner that would trigger FPA section 205 or 206 authority.⁸⁶

In *WSPP*, the Commission went on, however, to determine that where RECs and energy sales are bundled in the same transaction, its authority over practices “in connection with” wholesale sales is implicated.⁸⁷ The Commission applied this principle in *North. Am. Natural Resources, Inc.*,⁸⁸ calculating rates and refunds under a PPA that combined RECs and energy sales.

As this applies to a “co-optimized” market in which capacity trade are combined with trading of environmental benefits, this authority may very well pull the market for environmental attributes into FERC’s jurisdiction. That determination will depend on how closely tied these products are (whether the trading of environmental attributes is “in connection with” energy sales), and whether trading the environmental attributes may be said to affect the market for energy sales. In either case, FERC’s authority may be triggered. Factors relevant to that determination may include whether environmental attributes and capacity are combined in a way that makes these values inseparable when bids are evaluated, and whether a non-FERC jurisdictional entity administers the market for environmental attributes.

84 *WSPP, Inc.*, 139 FERC ¶ 61,061 (2012).

85 *Ibid.*, p. 18.

86 *Ibid.*, pp. 23-34.

87 *Ibid.*

88 *North. Am. Natural Resources, Inc.*, 168 FERC ¶ 61,041 (2019).